HOW TO MANAGE YOUR IMPACT INVESTMENT JOURNEY

By Rod Schwartz

The fast-growing impact investment industry is still approached with some reticence by cautious pension funds and other investors. A 4-step process will help ensure a smooth path into this activity.

The impact investment sector is booming. In the UK, the sector is estimated to be growing at +30% per annum and even faster elsewhere, where values-driven investment is somewhat newer. Nevertheless, a significant portion of institutional investors, in particular pension funds, are hesitant to engage. This is despite the market's growth, the decent returns which are available and broadening array of products.

This is especially curious given the growing level of genuine client interest. Such interest is particularly noticeable among high net worth investors (HNWIs) as they consider their heirs' desires. It is estimated by Accenture that $30 trillion of wealth will be passed on to 'millennials' over the next few decades. This generation is interested in the social impact of their investments as well as financial returns. Such considerations are influencing less wealthy 'retail' investors and even mainstream institutional investors are finding that this agenda is entering their in-trays.

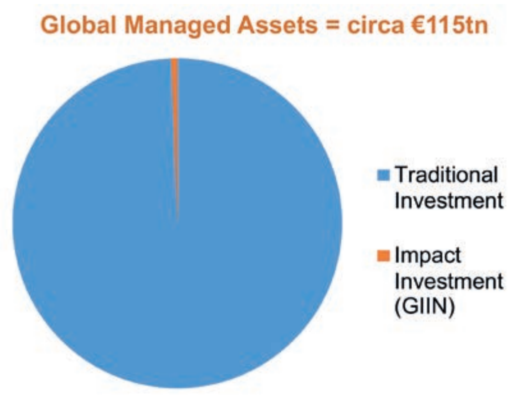
In our experience, much of this reticence can be explained by the relative newness of impact investing and an understandable fear of the unknown. Figure 1 highlights that only a small portion of professionally managed worldwide financial assets have an impact lens. Furthermore, there is a long-standing apprehension to commit to first generation products. Whilst we cannot assuage all these concerns, a simple 4-step process may help alleviate such concerns.

The first step in this process is to seek to understand the needs of the organisation regarding impact investing. Are there key stakeholder groups which are most likely to care about impact as a consideration, and if so, what are likely to be the nature of their concerns? Normally this is considered to exclusively refer to an organisation's clients; in the case of pension funds, the ultimate beneficiaries. We tend to operate on the presumption that their sole focus is to maximise risk-adjusted financial returns, but increasingly other factors are coming into play. This is not to suggest that client groups don't care about returns, but that the objectives may be slightly nuanced. Institutional investors should be encouraged to query (perhaps through surveys), the full nature of their client group's interest in this regard.

Other stakeholder groups to consider may include regulators, the general public and others. This is particularly true with investment organisations that have a high public profile. The increasing debate around an entity's 'license to operate' has moved non-financial criteria up the agenda. Of particular importance, although it is sometimes overlooked, are the needs of the staff in an investment organisation. We frequently find that it is employees that are driving interest in impact investment. Fund managers seeking the best available talent will ignore the needs of staff at their peril in a highly competitive labour market.

Once the broad needs of an organisation are considered, the fund manager must

Figure 1: Impact Investments: small but growing fast



Source: ClearlySo and the GIIN

take a view on the appropriate level of returns that an impact investment fund or portfolio needs to achieve to satisfy the needs of the relevant investor base. There is a growing variety of investment products, both in impact funds and direct investments, that seek market-rate returns. However, it may also be the case that for certain client types some trade-off between returns and impact may be appropriate. As part of this analysis fund managers need to consider that impact-related investments may be differently correlated or even uncorrelated to other assets. Reliable datasets are not readily available but initial indications are that impact-oriented investments boost diversification[1].

The third step in the process is to consider the most relevant product. For pension funds it is important to consider the liability profile of the beneficiaries, and this will drive product selection. Asset managers do need to recognise that nearly the entire spectrum of asset classes is available in an impact context. This includes fixed income, equities, private equity, venture capital, property and also combinations of the above. There are also products available which blend mainstream assets with impact investments. One of the best examples are the '90-10' funds made available in France under long-term investment schemes. Investors in these products know that at least 90% of their funds will be invested in mainstream assets and up to 10% invested in high-impact 'entreprise sociale'. However, to the best of our knowledge, some non-financial assets (art, wine, et cetera.) have no impact products, nor are there impact-oriented hedge funds.

The final step is unique to impact investing and involves the assessment or measurement of impact. The extent of the effort to do this will be driven heavily by the needs of key stakeholder groups mentioned in the first step. If there is a strong interest in, or an orientation toward investing for impact, a more comprehensive impact assessment and reporting mechanism will be appropriate. However, measuring impact is not straightforward and there are many variables, some relate to environment, health, poverty alleviation et cetera. As the need for comprehensiveness rises, the cost of measuring and reporting increases considerably, thus reducing available financial returns. Fund managers should think carefully before embarking upon complex and costly tools but need to make sure that their stakeholder needs are met. Our normal advice is to measure what matters most in the most straightforward manner feasible.

By following these four steps, investors will hopefully find that their entrée into the world of impact investing is relatively smooth and the excitement will be solely of a positive nature. These steps will not guarantee high levels of financial performance but will help to meet the non-financial needs of clients, staff, regulators and the broader community. «

1 See 'Allocating for Impact; September 2014, Subject Paper of the Asset Allocation Working Group, McGrath et. Al.'

This article was written by Rod Schwartz, Founder and CEO at ClearlySo.

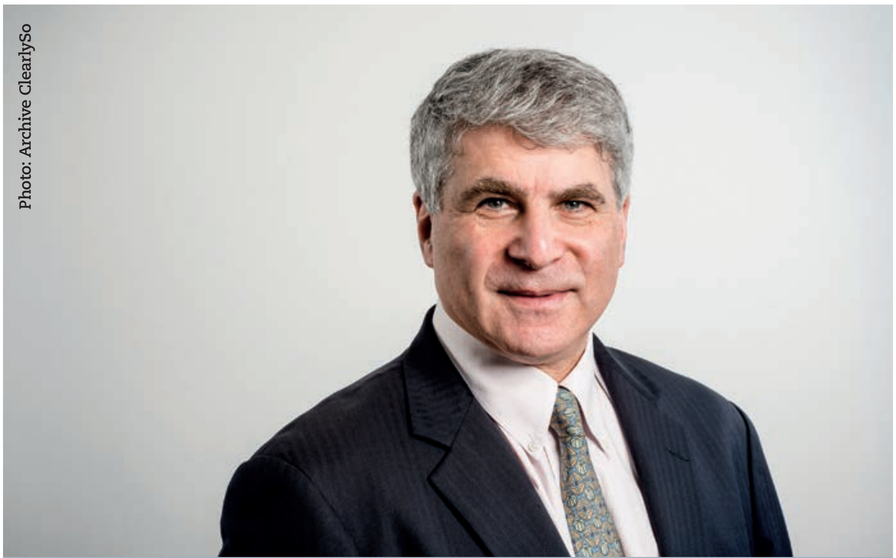


Photo: Archive ClearlySo

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Rodney Schwartz is Founder and CEO at ClearlySo, with a background in equities, financial research, investment banking and venture capital. Joining Wall Street in 1980, he rose to become the number one ranked financial services analyst at PaineWebber and then held senior management posts at Lehman Brothers and Paribas, before leaving the sector in 1997 to found the venture capital firm Catalyst. At Catalyst, Schwartz became passionate about innovative businesses that earn a living by trying to make the world a better place. A pioneer in this impact investment marketplace, he transformed Catalyst into a social business consultancy and in 2008 launched ClearlySo, which raises investment for high-impact businesses, charities and funds. Today ClearlySo is Europe's leading impact investment bank, and has helped more than 130 clients raise more than £200 million in investment capital by leveraging its extensive network of high-net-worth individual and institutional investors. Schwartz teaches impact investment at ESMT in Berlin and has guest-lectured at other European universities, and is a regular sector commentator and writer. He is a past Chair of Do The Green Thing, a charity that uses creativity to tackle climate change, Shelter, the largest UK homelessness charity, and JustGiving.com, the world's largest online donations platform. He holds an MBA and BA from the University of Rochester, in the USA.