IMPACT INVESTING

USING CAPITAL TO CATALYSE CHANGE FOR YOUR FAMILY'S FUTURE

David Merton

Joanna Kirby

TIME PARTNERS

Joanna Kirby is a managing director and David Merton is an associate director at Time Partners, an investment and strategic advisory firm, focusing on private markets globally.

Impact investing is one of the fastest-growing areas of finance. The Global Impact Investing Network estimates the impact investing market to be some $715bn* as of April 2020, up a huge 42% from the $502bn just a year before. In this article, we outline what impact investing is, why its growth will continue and how families can use the asset class to catalyse change whilst at the same time meeting their financial objectives.

What is impact investing?
Impact investing is simply investing to create a positive output/impact in addition to one's financial goals. The 17 United Nations Sustainable Development Goals (UN SDGs) are typically used to direct and measure any impact, we broadly classify these as environmentally focussed or socially focussed, with some additional SDGs that are consequential to the two groups, such as eliminating poverty.

An assessment of ESG (Environmental, Social and Governance factors) is now almost always considered in 'traditional investing' but the degree and sophistication of the evaluation can vary enormously from manager to manager.

ESG is a means of assessing risk, one example is the degree to which climate change may affect an investment thesis. Impact investing takes this a step further and requires an additional positive impact, using our climate change example, this could be to reduce or eliminate the carbon footprint of a particular process, the success of which is measured and tracked.

Considering long-term themes when allocating capital, many of which align with goals such as the UN SDGs, is an example of value creation. Almost all long-term investment themes align with one or more of the UN SDGs, such as funding renewable energy, zero-emission transport, or advancing healthcare. The proverb "a person who chases two rabbits catches neither" suggests pursuing two goals will mean you end up failing on both. Impact investing is often viewed in the same vein with financial goals and impact goals as somewhat mutually exclusive concepts - impact coming at the expense of return. We don't see it that way. Whilst there are many 'impact first' opportunities that do indeed offer lower rates of return nearly 70%* of impact investment opportunities provide at least market-rate returns. This is possible because a lot of the time the rabbits are running in the same direction - reducing waste, lowering carbon output, or producing better and more effective healthcare are all more profitable and impactful activities.

Measurement is key
Unfortunately greenwashing is common as managers try to gain a piece of the rapidly growing impact pie. The many different impact measurement methodologies, guidelines, and interpretations make comparison difficult. In our view, quantitative impact metrics are easily identifiable and measurable, but consideration should be given to qualitative metrics to provide narrative. Furthermore, impact should be intentional, not incidental. When considering an impact investment opportunity, a thorough understanding of these considerations is needed, together with the alignment of beliefs between manager and investor.

Public or private market?
Whilst impact investing spans listed and unlisted markets, we believe private markets offer the best opportunities with even greater impact. Once a company is accessing public markets it is usually of significant scale and more focused on quarterly earnings. Private markets allow investors to provide capital at all stages of a company's lifecycle with a more direct cause and effect linkage between capital input and impact output. The long-term investment horizon, hands-on operational approach, and ownership influence are very effective at driving change within a business; this active ownership is not replicated through shareholdings in public stocks. Private markets offer better governance too, given many private investments come with a controlling stake over the company or asset. Impact investing is often related to new technologies and earlier-stage businesses so naturally better suits venture capital and private equity.

Mobilising capital to effect positive change
Corporate purpose is strongly linked to sustainability and impact. Ever-widening wealth disparity, the rise of populism and government paralysis on many important social and environmental issues mean capitalism can no longer solely focus on shareholder wealth. Milton Friedman introduced this concept in the '70s and it has been at the heart of capitalism since.

Firms need to create value for their stakeholders, expanding the value creation from shareholders to employees, customers, and wider society. Companies that optimise for stakeholder wealth are less likely to see regulator intervention, often have higher brand value, and can more easily attract talent.

Many institutional investors see ESG factors as an integral part of the investment process with their focus now increasingly turning to impact investing. Family investors tend to be further ahead in this journey, often led by the younger generation who see the alignment of financial objectives integral with their social and environmental responsibility.

The pandemic has catalysed this, highlighting some of the key challenges that need to be addressed like income inequality, access to healthcare, and environmental issues. We are firm believers in the positive correlation between impact and financial return as more people start to invest, work, and buy from responsible companies.

The impact investing universe is now large and varied, requiring expertise and experience to navigate effectively. The consideration of impact offers a lens through which to build a portfolio for all generations, tackling some of the world's most pressing issues, without necessarily sacrificing expected return.