Social Investment

Finance: Blessed returns

Pope Francis has little good to say about capitalism but has championed impact investments

The Big Read

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The finance industry presents a bewildering array of options for anyone looking to increase their savings, from "60-40" portfolios to newfangled concepts like "smart beta", but rare is the investment strategy that has been blessed by the Pope.

When the Vatican assembles investors, entrepreneurs and academics for its second Impact Investing Conference later this month, it will do so as the mainstream wealth management industry has started to catch on to the term. Impact investments are made with the aim of generating not just a financial return but also a measurable social or environmental one. It is an alluring — if often elusive — proposition: doing good while also making money.

Pope Francis has made it a theme of his papacy that capital markets should be redirected to help the poor, and the conference will explore how the Catholic Church might channel some of its riches to impact investing. Wealth managers are perhaps more concerned with mammon than with God: they have watched as some very rich clients pulled their money from firms who cannot offer impact investing advice.

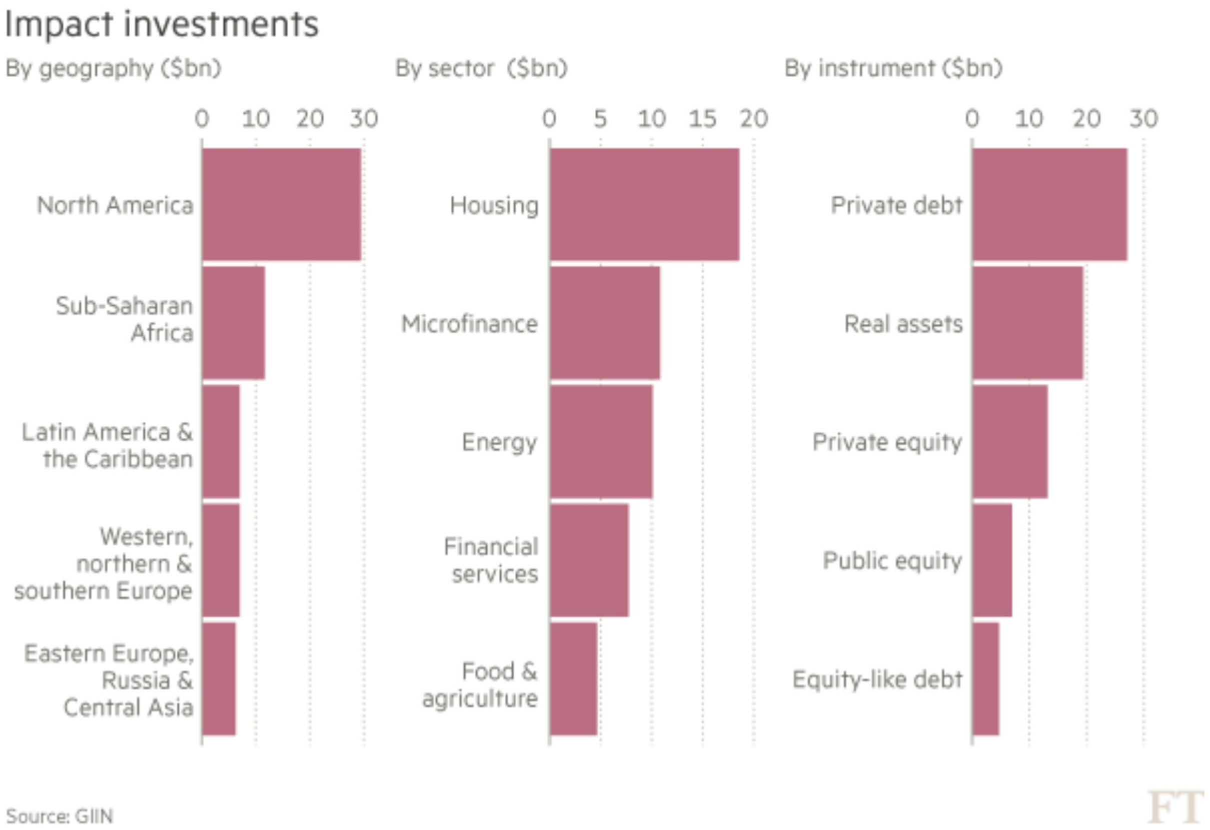
Across the industry, executives are looking at ways to cater to the millennial generation, which seems far more attuned to the idea of investing as a way of improving society. And while they may not have much in the way of assets yet, millennials will inherit some $30tn — the biggest-ever transfer of wealth.

“Fifty-eight per cent of baby boomers say that social and environmental impact is important” with regards to their investments, says Jackie VanderBrug, investment strategist at US Trust. “Ninety-three per cent of millennials will say that. In fact, millennials are starting to say, why are you even asking me this question?”

Measurable good

Until recently, impact investing has been the preserve of rich families, philanthropic foundations and a few, often faith-based, institutional investors. In contrast to wider concepts of socially responsible investing (SRI) or environmental, social and governance (ESG) investing — for instance, attempts to screen out firearms or tobacco companies, or to engage with companies to improve their social policies — impact investing requires explicit work to set targets for, measure and compare the social effects of one’s asset allocation.

The Global Impact Investing Network, set up to track and promote the field, can find only $77.4bn as of the end of last year, specifically in impact investment funds. These are most often channelled to microfinance programmes, like those lending seed capital to female entrepreneurs, and developing infrastructure projects. Other asset classes include affordable housing and sustainable forestry, where the number of “teachers housed” or “hectares planted” can be easily counted. Private equity-style funds also channel money to for-profit companies whose products aim to aid the environment or provide jobs for underserved populations.



Asset management groups have scented an opportunity and are racing to develop products that can be sold under the impact investing umbrella to a wider range of clients, promising market rates of return. In the philanthropic sector — the term impact investing was coined at the Rockefeller Foundation a decade ago to refer to market-based solutions to social problems — there is hope for a wave of new money that could amplify charitable spending.

But on both sides there are voices urging caution. Will investors get the financial returns or make the impact they are promised? How can someone quantify the positive effects of their money? And can impact investing be scaled up to retail investor scale without making a mockery of the original concept?

Rich families believe they are blazing a trail others will follow. Justin Rockefeller, great great grandson of John D Rockefeller, and other wealthy scions have set up The ImPact to share investment ideas and urge wealthy families to consider "all the tools on their tool belt" to tackle the world's problems. Networks of impact investors are springing up in many countries, from Clearly Social Angels in the UK to Silicon Valley entrepreneur Charly Kleissner's Toniic in the US (set up as a counterpoint to GIIN — "pun intended").

The Rockefeller Brothers Fund, a family foundation set up by descendants of the oil baron, ditched its investment adviser for Perella Weinberg, which will help the fund extricate itself from funds that invest in fossil fuels and move more heavily into impact investing.

Liesel Pritzker Simmons, scion of the Pritzker family, decided after the financial crisis to shift all her assets to impact investing. Wealthy families, she says, are in a position to support new impact investing funds while they establish a track record — essential if they are to catch on with investors. “Previously it had been seen as tree-huggery,” she says. “As a millennial woman, I’m a walking example that it’s not just marketing.”

The G8 nations have promised to encourage impact investing; in the US charitable foundations have been given more clarity on the tax treatment of such investments, and pension funds have been told they can include social and environmental factors without breaching their fiduciary duties.

Asset managers are responding. Goldman Sachs has acquired an impact investment boutique called Imprint Capital. And Bain Capital has tapped the former governor of Massachusetts, Deval Patrick, to launch an impact investing fund, in what could be the biggest move yet by a traditional private equity firm into the sector.

‘Little hardcore experience’

The key to making good impact investments in private equity is finding ventures where the social return is at the core of their business model, said Brian Trelstad a partner at Bridges Ventures, a £600m impact fund manager co-founded by Sir Ronald Cohen, who started Apax Partners.

“We try to select businesses where, if they are having impact, it drives more commercial returns and if they have more commercial returns it drives more impact,” Mr Trelstad said.

That way, the pursuit of profit is not going to derail a company from its mission, he said.

Advocates of impact investing point to a study by the Wharton Social Impact Initiative, based on data stretching from 2000-14, to demonstrate that it can work. The study found that the pooled internal rate of return of 170 investments made by 32 impact private equity funds was 12.9 per cent. That matched small-cap benchmarks, though it might seem low compared to the risks associated with private equity. Either way, the sample is small, given the nascent state of the industry.

Julia Balandina-Jaquier, who ran one of the first impact investment funds for AIG before becoming an adviser to the sector, says the arrival of established private equity players is a welcome development. “A lot of funds were started by NGO guys or people with good intentions but little hardcore investment experience,” she said.

Other recent work has focused on creating fixed income products, which are broadly known as social impact bonds. Green bonds might finance a solar project, for example, at a guaranteed rate of interest while others might fund services for a government, such as an asthma prevention programme and pay a return based on how successful it is in saving the government money.

In another innovation, the Calvert Foundation, a non-profit organisation, is issuing bonds to fund an impact investment portfolio it is running with the MacArthur Foundation of Chicago, which will itself invest in social ventures aimed at revitalising the city’s economy. It is a reminder that, while many of these instruments promise “market rate returns”, they might be underwritten by non-profit groups willing to take risks traditional investors would not.

‘I bless your work’

Fraught debates about what constitutes impact are never far from the surface. The GIIN lists 559 metrics from “greenhouse gas emissions avoided due to products sold” to the “number of suppliers who were minority/female/low income”.

Others say simpler frameworks are needed, a point made by Howard Buffett, grandson of Berkshire Hathaway founder Warren Buffett. Sixty years ago, the elder Mr Buffett developed his value investing approach under the tutelage of Benjamin Graham at Columbia University; today his grandson is lecturing on impact investing there, and developing his own system to predict future impact per dollar invested for similar investments. That system, the younger Mr Buffett says, “is adapting value investing principles to the world of impact investing”.

With a co-founder, Mr Buffett has started an impact investing fund of his own, called i(x) Investments, which will put money into companies dealing with water scarcity or sustainable agriculture, among other areas.

"The impact investing field needs to continue deciding on and simplifying some broad definitions, and also needs to continue drawing some boundaries and scope around what is and isn't impact investing," he said.

For wealth managers and asset management firms, the broader the definition the better since, as a marketing term, "impact investing" trumps ESG, SRI and the other acronyms associated with investing with a conscience. However, there is debate about how far the term should be applied to stock market investments, since a purchase of shares in the secondary market from another seller hardly has the same impact as directly funding a start-up.

To Deborah Winshel, poached last year by BlackRock from the metrics-obsessed New York anti-poverty charity Robin Hood Foundation to run its impact division, placing too many restrictions on the investments ultimately limits the possibilities of impact investing. Semantic debates — "splicing words", she says — are also seen as unhelpful.

"I have tremendous respect for the impact sector and the work they have done but it is very hard to scale and mainstream those kinds of investments," she said. "For BlackRock, given our scale and our size, it is about creating those opportunities that are available to all of our investors."

BlackRock says it manages $200bn of assets in impact products, counting equity funds that simply screen out "sin stocks". In the past year, it has launched two public equity funds that pick stocks using an impact scoring system for "green innovation, corporate citizenship, high-impact disease research, ethics controversies and litigation".

As he prepares to address the Vatican conference, Amit Bouri, chief executive of the GIIN, says his goal is for investors to think "about the direct and indirect impacts of the investments they are making".

It was a point Pope Francis made at the Vatican's first impact investing conference two years ago. "It is increasingly intolerable that financial markets are shaping the destiny of peoples rather than serving their needs, or that the few derive immense wealth from financial speculation while the many are deeply burdened by the consequences," he told attendees then. "With great affection I bless you and your work."

Additional reporting by Mary Childs in New York

An earlier version mischaracterised the Rockefeller Brothers Fund as a family office

Case studies: Thin line between success and failure

In the wake of the global financial crisis, UK impact investment fund Bridges Ventures wanted to tackle one of the big barriers to reducing soaring unemployment: a deep skills gap among the young.

"We hit upon the idea of apprenticeships as a way of getting young people . . . into jobs and training at the same time," says Michele Giddens, Bridges' co-founder.

Its chosen investment was Babington Group, an East Midlands company founded in 1974 that offered apprenticeships and jobs-focused education programmes. By the time the company was sold for £22m in April this year, Babington had supported 32,000 apprenticeships, helped 3,700 previously unemployed people find work and increased annual revenues from under £2m to more than £15m — as well as earning Bridges an internal rate of return of 33 per cent.

The short history of impact investing, however, also contains examples where investors have failed to generate the intended financial or societal returns.

The Murex Investments I Fund — launched in 2003 to help social entrepreneurs — was taken over by the US Small Business Administration last year after breaching the terms of an $8.3m loan from the federal government. The loan accounted for most of the $13.8m it had raised to invest in local Philadelphia businesses.

Along with several successful investments, including in money transfer group PayQuik, Murex also took a 44 per cent stake in Advanced Workstations in Education, which sold computing equipment to libraries. When the company went bankrupt in November 2014 it sealed the fund's fate sparking recriminations over the restrictions on investments that come with government loan guarantees. *Adam Samson*

Letter in response to this article:

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