Impact investments could do better

A significant gap remains between the appetite and actual understanding of impact investing, holding back the sector's true potential

Felicia Jackson

Socially conscious investment is the flavour of the moment, with frequent headlines highlighting sustainable environmental, social and corporate governance (ESG) policies. It's tempting to think that maximising financial return is no longer the sole focus of long-term investing, but is this really the case?

Despite the widespread coverage, there seems to be limited understanding of the opportunities offered by impact investing.

A survey from Swiss wealth manager Vontobel discovered that 59 per cent of people don't even know that an ESG approach to investment is possible. Meanwhile, research from law firm Michelmores reported that 73 per cent of affluent millennials feel they have a responsibility to use their money to have a positive impact on the world, yet only 16 per cent have actively invested in sustainable or social impact funds.

There is a real danger that the disconnect between customer interest and lack of information, combined with inadequate client support, could hinder the sector's growth. The good news is that nearly 50 per cent of Vontobel's survey respondents would like their advisers to provide more guidance.

Ben Faulkner, marketing communications director at EQ Investors, says impact investing has this year come of age. "Heightened awareness of climate change is a significant driver as are corporate scandals such as the Volkswagen diesel emissions episode. These concerns and poor practices irk ethically minded investors," he says.

David Stead at the Charities Aid Foundation says interest is growing, especially among millennials and those high-net-worth individuals (HNWIs) with a financial background, who "want to receive a return on capital while also pursuing social or environmental aims".

There is no doubt that ESG is going mainstream as it's a useful approach to managing risk and signatories to the Principles of Responsible Investment, supported by the United Nations, already account for half of global assets, with $80 trillion under management. Less easy to quantify is what is really happening in the impact investment market.

At just over $500 billion globally in 2018, it remains a fraction of the size of the ESG market. Rapid growth is expected because, as Mr Faulkner points out, impact investment offers a new approach "by capturing potential competitive advantages, megatrends and legislative support".

Alexandra Daly, founder and managing director of independent agency AA Advisor, says: "High-net-worth individuals see an opportunity to capitalise on this shift and be proactive rather than reactive."

And demographic change will play a role in the sector's growth. Oliver Gregson, UK and Ireland head of J.P. Morgan Private Bank, says: "Eighty-seven per cent of millennials indicated the importance of ESG in investment decisions."

Ideally, HNWIs of all ages would be the target market, says Mr Stead. Investors will take a broader approach to the use of their funds – a new kind of portfolio of all their assets – which, depending on their personal values and objectives, will be a mix of philanthropy, impact, social and ESG investments and investing aligned to the UN's Sustainable Development Goals, he says.

According to the US Forum for Sustainable and Responsible Investment, 25 per cent of every dollar invested in America goes into sustainable investment. Part of the challenge is that the rise of socially conscious consumers and investors is resulting in increasing demand for investment products which may not actually yet exist.

Philip Radford, director at wealth managers Saffrey Champness, says: "Specialists are very knowledgeable about impact returns, but there is a market challenge around education and availability of product."

This, however, looks set to change as Mr Stead says November will see the launch of the Impact Investing Institute and part of its mandate will be to drive engagement with the retail sector.

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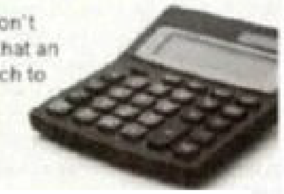
Vontobel



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Vontobel

62% of millennials think impact investments are less profitable than other investments

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Greenwashing, making an unsubstantiated or misleading claim about environmental benefits, is always a concern with the packaging of new products and services. Historically, the problem has been a lack of transparency and independent ratings. But Meg Brown, chief executive of Impax Investment Management, sees a slightly different issue.

"Big passive portfolios looking at ESG risk allocation are good, but this doesn't make them a positive allocation choice," she says. "ESG will take out the worst, but it's not an investment in the future, not intrinsically a positive portfolio. That's why people get confused about greenwashing. You need to understand the logic of how the investment will deliver on objectives."

One area where impact investment can play a useful role in a portfolio is diversification, in that impact investment returns are not correlated with market investment performance. Whether you're investing in gyms in underserved areas or providing micro-finance for Nigerian farmers, your return will be non-correlated with market returns. In a market where interest rates remain low, impact investments can provide a significant opportunity for financial return.

While Mr Radford sees some forms of impact investment as closer in nature to philanthropy, he agrees with the view that impact doesn't have to sacrifice return. Where impact investments can be a challenge, however, is in terms of liquidity. He sees liquidity, transparency and the knowledge barrier as the key brakes on market growth.

But for those who are planning for a long-term future, longer-term investment requires a different mindset that is open to the changing nature of the global economy and ability to hold on to an asset through market changes.

As Marga Hoek, author of The Trillion Dollar Shift, says: "Growth private equity opportunities directed by the Sustainable Development Goals are longer-term investments, creating sustained value as compared to catering to shareholders' requests for short-term payouts."

Portfolio future-proofing, diversification and an opportunity for positive returns in a low interest rate market mean impact investing is on the rise, all while making the world a better place.

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