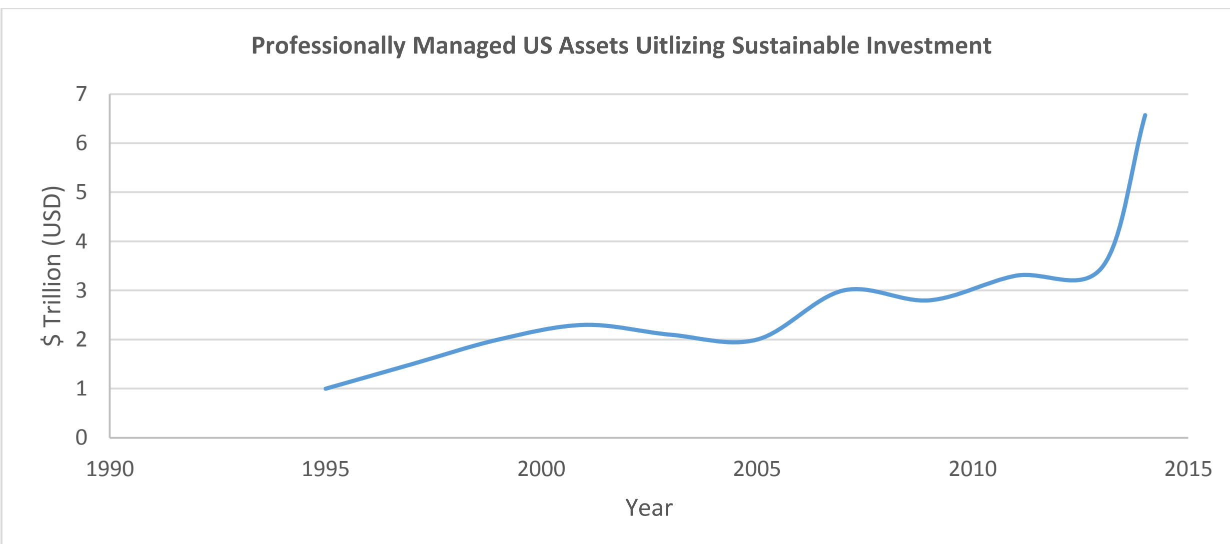
“INVESTING FOR THE GOOD”

INTRODUCTION

The marriage between the for-profit and non-profit sectors resembles the feuding relationship between the families of Montague and Capulet – irreconcilable and marked with heated arguments for centuries. The main debate centers on that there must be a trade-off between the two – social good, and financial profit – and doing good is for the light-hearted ones who are not equipped to do well. However, in light of the 2008-2009 Financial Crisis, with the traditional finance system in tatters, rising out of the ashes is a new asset class named “impact investing”, and it is drawing the attention of private and public investors alike. According to recent research done by Morgan Stanley’s Institute for Sustainable Investing, the area of social investments has been growing fast: in 2012, with $1 out of $9 qualified as sustainable investments (a total of $3.47 trillion in assets), while this increased to $1 out of $6 in 2014 ($6.57 trillion). Growth in the area of impact investments is expected to continue; however, much of the old debate will persist. Despite these difficulties, I firmly believe that the area for social impact investing has much potential, and the purpose of this article is to highlight the growth opportunities, problems remaining to be tackled, and some possible resolutions for these problems.



Caption 1: The total volume of sustainable investments nearly doubled from 2012 to 2014

Source 1: USSIF, “US Sustainable, Responsible and Impact Investing Trends 2014,” November 2014

Impact investing defined

Impact investing is defined as “investments made into companies, organizations, and funds with the intention to generate social and environmental impact alongside a financial return,” according to the Global Impact Investing Network (GIIN). The practice of impact investing is marked by three characteristics – financial and social return, intentionality, and measurement. Distinction of impact investments from philanthropy needs to be made, where the latter treats investment in social goods as a side project that will generate zero financial return while impact investing requires all practices of investments to be socially mission-driven, and yielding financial returns at the same time.

There are several dimensions towards impact investing. These investments span across sectors such as sustainable agriculture, clean technology, microfinance, and affordable and accessible basic services including housing, healthcare, and education. Impact investments also take many forms. For example, it can take the form of a social impact bond (SIB) or the form of social impact equity portfolios. Social impact bonds have been widely used by the British and Canadian government to provide better solutions for pressing social issues, such as prisoners' rehabilitation, foster care placement, and climate change. A recent SIB divided the investment between a fixed-rate loan to a social housing provider (riskier), and providing therapeutic support for children (less risky). Impact investment funds, such as LeapFrog Investments, create portfolios that target specific areas of social needs, are also mushrooming up across Europe, North America, and Asia. A wide spectrum of impact investors is attracted to impact investing, such as diversified financial institutions, pension funds, private foundations, development finance institutions, fund managers, and individual investors.

Driving forces

In "Sustainable Signals: Individual Investor Perspective", Morgan Stanley's Institute for Sustainable Investing identified 2 main types of investors that will be driving growth in impact investing over the next 5 to 10 years. They are the millennials and women. Millennial investors are 84% more interested in impact investing compared to other generations. Additionally, statistics in the research also demonstrates that millennials are also twice as likely to factor sustainability into areas of their lives other than investing, such as purchasing behaviours, and employment. This matters because by 2020, 33% of the U.S. population will be a millennial. As this generation begins to accumulate more wealth and invest accordingly, their perceptions of sustainability are likely to have a significant impact on the financial services sector. Furthermore, female investors are also twice as likely as their male counterparts to consider both financial and social rates of return when making investment decisions (40% vs. 23%). Female investors are more likely to believe environmental, social, and governance factors are important aspects to consider when making an investment (76% vs. 60%). As women's financial and business power increases – 52% of all managerial and professional jobs in the U.S. are now held by women, and American women control $11.2 trillion in investable assets (39% of the nation's total investable assets) – financial services providers need to consider values of their potential customers.

Deterrent forces

Despite the potential associated with impact investments as an alternative investment option, there remain some naysayers that raise three red flags that may be worth noting. **Firstly**, creation of social capital markets lacks a common measure of how much good has been done. There is no agreed unit of social impact. The meaning of social goods would be different for people with different values, while on the other hand, everyone would perceive financial return as the same. **Secondly,** social impact investing often face criticisms, such as "these investments are basically making money off the back of the poor", and "most of these investment program focused on social goods are more short-term rather than longterm oriented." However, the current financial market is already fraught with the problems above, and impact investing may offer a comparatively better solution than the existing status quo. **Thirdly,** there exists continuous debate around what constitutes "impact". Both Apple, and Tesla are traditional firms that also generate a lot of social happiness, and they are able to generate excellent financial returns as well. However, that is largely a matter of semantics as the term "impact investing" mostly refers to the social and environmental sectors, which have not attracted much attention from private sectors previously.

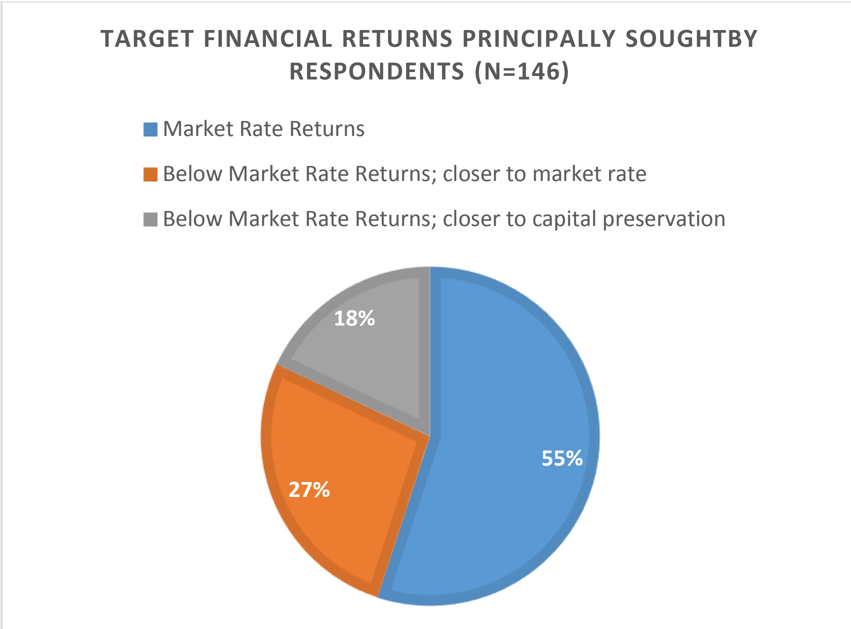
Possible solutions

The lack of standard measurement for social impact has been partially resolved by the **Global Impact Investing Rating System**, which provides both company and fund impact ratings derived from the B Impact Assessment. The report provides a rating that is analogous to those of Morningstar investment ratings or S&P credit risk ratings, except it measures social and environmental impact of an individual company or fund. The GIIRS is used widely by investors worldwide to evaluate small and medium-sized enterprises (SMEs) in developing countries, and investment funds are evaluated based on the ratings of the portfolio of companies they invest in and the operations of the fund manager.

On the same tangent, the writer would like to propose several other solutions in terms of legislation, and alternative financial product construction. For example, governments, to encourage more social impact investment, should allow for tax deduction on any capital gain that investors have made in social enterprises. Alternatively, each individual has the option of setting up a financial account where the investments would be made in the social sectors only, with special perks that are similar to those of a TFSA. In addition, newer and more creative "social" financial vehicles can be created to increase access of resources to the average investor. Sustainability bitcoins can be created where the money that is invested in social enterprises could be used to purchase or exchange for products that center around the concept of sustainability, such as organic vegetable or recycled products. From a macro-perspective, a stock exchange with only stocks of sustainable social enterprises can be created – TSX, TSX Venture, or TSX Social Venture?

CONCLUSION

Despite the low involvement rate in the area of social impact investments, I remain hopeful for opportunities in the future. Currently, many individual investors are already demonstrating their interest in the area of social finance – JPMorgan predicts that by 2020, there could be between $400 B and $1 T invested this way, generating cumulative profits over 10 years between $183 B and $667 B. Additionally, mainstream firms, such as Black Rock Inc. and Goldman Sachs, have also started to launch investment products that take into account environmental, social and governance (ESG) factors. Regardless of the optimism, more work needs to be done to help educate investors that positive impact and the potential for market-rate financial returns can be pursued simultaneously. Looking at the dismal performance of the oil and gas industry (sin investments) over the last 6 years, it is apparent that alternative opportunities should present themselves, and make radical changes that shatter the status quo to jolt the world economy forward during this time of crisis.



Source 2: GIIN, J.P. Morgan, "Eyes on the Horizon" 2015

Subtitle: Impact investing continues to meet hurdles because of the perception that there must be a trade-off between social good and financial performance

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