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Impact Investing: A Shifting Mindset Across Public and Private Markets

Disruptive Forces in Investing

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Anu Rajakumar: Impact investing is defined by the Global Impact Investing Network (GIIN) as investments made with the intention to generate positive, measurable, social and environmental impact alongside a financial return. Today's impact investors are proactive and know that harnessing the immense power of the investment community has the potential to yield enormous societal gains. To share perspectives on this important topic is my colleague, Jennifer Signori, from Neuberger Berman's ESG and impact investing team. Jennifer is responsible for integrating environmental, social and government, or ESG, considerations across the Neuberger Berman platform, and leads the development and execution of impact investing strategies with a focus on private equity. Jennifer, welcome to the show.

Jennifer Signori: Thank you. It's a pleasure to be here.

Anu: Ethical and socially responsible investing have been around for a long, long time. But impact investing appears to be a newer term, which has created a huge market for itself, now easily over half a trillion dollars. Jennifer, can you talk about the growing interest investors have taken toward this method of investing, and explain why?

Jennifer: Sure. So historically the emphasis was on avoiding certain sectors or industries, which has its limitations. The mindset generally speaking has shifted to “how can we contribute to the solution?” And given that many of the same issues have persisted for many, many years, and the traditional players of government and nonprofit organizations can only do so much; and then on top of this, the flow of information is much faster and much more transparent, where people are more aware of the urgency and the magnitude of these issues like climate change. And this is prompting action. We see a broader shift in how consumers are spending their dollars. So for instance, consumers increasingly care more about how their products are sourced and produced, how companies treat their employees and the overall effect the products have on the planet as well as their own health. In response to this, more and more entrepreneurs are building companies to respond to this demand and helping to provide a capital market solution to these challenges with sustainable business models that can grow and scale. And then this mindset crosses over into how individuals want to invest their money. So there is a generational wealth transfer on the horizon. Millennials will inherit 30 trillion dollars by 2050. And according to many different surveys, anywhere between 70 to 90 percent of Millennials are interested in having positive impact with their investments.

Anu: Absolutely. And it's not just the Millennials looking at their own portfolios and demanding this. The pressure is on the large institutions as well.

Jennifer: That's right. So it's not just the obvious investors like individuals, family offices or foundations focusing on impact investing. If you take a step back and think about pension funds, essentially pension funds are managing retirement assets on behalf of many, many individuals. So collectively these individuals are increasingly asking for more sustainable or impactful investments in their portfolios.

Anu: Now I started off the show with a very official definition of impact investing, but how is this concept actually put into practice and how does that differ across various asset classes?

Jennifer: So as I mentioned, with a solutions mindset, we need to first ask ourselves what is the social or environmental challenge that we're looking to address? A common framework or agenda that investors have been gravitating towards is the United Nations Sustainable Development Goals. And this has been helpful to have a common set of social and environmental objectives that governments, companies, investors, can rally around and work towards together. And what we've done is to evaluate the specific goals and targets to then look at business models and determine which ones we think are investable. So looking at the core business in terms of products and services, and how are they providing solutions to these challenges. And this can apply across asset classes. So for instance, our municipal bond team, what they do is they identify bonds that are financing projects like recycling facilities, like K-12 schools, and they're looking at the use of proceeds of these bonds. And they're directing the capital to geographies that they deem to have a higher relative need, and to deliver measurable, positive outcomes for people on the planet, such as carbon emissions avoided or new classrooms constructed. And this is of course with the understanding that this is part of a broader solution towards improving educational outcomes—but within the confines of what is possible in the municipal bond market.

Anu: And you spoke about global coordination with the UN goals. I'm just curious about what adoption rates look like in various regions across the world. For example, developed markets vs. emerging markets.

Jennifer: This is a global phenomenon. The European market has had a head start and they're further along. But the U.S. and Asia are quickly catching up. This is in terms of the investor interest and demand. But on the investment side, in terms of investable opportunities, I think historically there's been a lot of emphasis on emerging markets. So think about bottom of the pyramid or microfinance opportunities in the past. What I will say is, is with rising income inequality, with the ubiquitous nature of climate change, these are across the globe and there's actually a lot of opportunity in developed markets as well.

Anu: Now let's talk a little bit about evaluating an investment from an impact perspective. How is impact measured?

Jennifer: So we evaluate investments across different dimensions of impact. And theoretically you could apply this lens or evaluation to really any company or any investment. We want to understand how are people and planet affected, through a company's products and services, as well as their operations. So these five dimensions of impact are what, who, how much, the contribution to impact and impact risk. We want to understand the products and services of a company, and how are they affecting people and planet, and what outcome is being targeted. We want to understand how much impact is being generated. So the scale, the depth, the duration, for instance, and really importantly who is affected by the company and their activities. So the customers, are they in higher relative need? Who's affected? And then contribution to impact. So what is the unique contribution of that company towards those outcomes that you're targeting? And then lastly, impact risk. So we want to understand the likelihood that the intended outcome will or will not occur. After assessing all of these dimensions of impact, you can roll them up into broad categories of how a company is acting to avoid harm, benefiting stakeholders or broadly benefiting society, or actively contributing to solutions. Impact investing historically has been more concentrated in private markets. So you could see why, right? Private equity managers, they own, control companies. They sit on boards, they can drive change. In addition to that, the depth of impact is often, more tangible in the private markets. That being said, the public markets have tremendous scale and the effect that public companies have on various stakeholders is really difficult to ignore. The tools available to public markets investors will be different though.

Anu: Do you directly engage with companies if you see opportunities with potential ways that they could improve their impact?

Jennifer: Engagement is an important tool, I would say especially in the public markets. So we engage on a variety of topics that are environmental, social or governance in nature; impact in terms of how a company is affecting people and the planet is another part of that engagement agenda, or the possible ways to engage with a company. So absolutely. We think that that is a tool that public markets investors have to help drive change.

Anu: What sort of time horizons do investors typically consider?

Jennifer: In terms of time horizon, typically investors who have a long term view care about these long term sustainability issues. Asset classes like private equity, lend themselves to a longer time horizon. But that being said, there are opportunities in the short to medium term as well. So for example, there are opportunities in the municipal bond market, where there are multi year serials for a given bond issuance. So there are ways to access opportunities that have a positive impact across time horizons.

Anu: And given that this is a relatively new market, how do you manage the appropriate balance between risk, returns and impact?

Jennifer: The balance between risk, return and impact will vary by investor depending on their financial objectives and their constraints. So things like liquidity needs, their risk tolerance, you can maximize for impact accordingly. So for instance, for the impact strategies that we manage, we're not looking to compromise on risk or return in order to achieve impact. We're trying to find the pockets of opportunity where we can deliver impact in addition to a comparable risk return for that asset class, for instance. Other investors may be able to be more patient with their capital, right? So they can take on more risk in a way that catalyzes greater impact or brings in additional capital.

Anu: And finally, what do you believe are some of the major trends that will shape the future of this space? Are there any interesting innovations you've seen recently with regard to impact investing?

Jennifer: So one observation is, there is an increasing focus on coalescing around a common set of standards, definitions, language, on how to manage, measure impact. I think this will help investors to sort through the noise and to be able to compare and understand how one investment's impact may vary from another. So the hope is that this will help bring in capital from the sidelines once there is more clarity around this. We're also seeing greater focus on climate. So not only investing in specific companies or projects related to obvious areas like renewable energy or electric vehicles, for example, but asking how does climate risk affect all of my investments. So there are some interesting ways big data and AI are being used to understand the relative climate risk as it relates to physical risk and transition risk, to assess these issues. So for example, we've been able to leverage our big data team and our insurance link strategies team to assess the probabilities of physical weather related risk to a particular investment that had a concentration in a single location, for example.

Anu: Yeah, that's really fascinating. Well, I think that'll do it for today, Jennifer. Really appreciate your time. It seems like the big takeaway here is that it turns out that what's good for people and good for the environment is ultimately and in the long run good for business and good for shareholders.

Jennifer: Absolutely.

Anu: Thanks for tuning in to this episode of Disruptive Forces. If you like what you heard, I hope you'll subscribe via Apple Podcasts or Google Podcasts. For previous episodes as well as more information about our firm and offerings, please visit www.nb.com/disruptiveforces.