Investors can achieve market-rate returns and their social impact goals

Naomi Friend *(www.cambridgeassociates.com)*

Impact investing has come of age. Total assets in impact investments were estimated to be $60 billion at the end of 2014, with growth of 16 per cent expected in 2015, according to data from 146 respondents and collected by the Global Impact Investing Network (GIIN) in *Eyes on the Horizon,* its 2015 Impact Investor Survey.

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There are two main drivers of this growth: one, asset owners have an increasing desire to invest responsibly; and two, there is a rising interest in using impact investing as an efficient way of meeting their social impact goals. According to the 2014 World Wealth Report, produced by Capgemini and the Royal Bank of Canada, 92 per cent of High Net Worth investors ascribe importance to driving social impact, with 60 per cent saying it is extremely important.

We are optimistic that investing for impact will move into the mainstream in the years ahead. Investors have an increasing awareness of the importance of environmental and social factors that have tended to be overlooked by traditional approaches to financial analysis. The UN-supported Principles for Responsible Investors encourage investors to demonstrate their commitment to responsible investment and to incorporate environmental, social and governance considerations into their investment decision-making and ownership practices.

Long-term asset owners – such as foundations and endowments, pensions and families – are becoming ever more thoughtful about aligning their investment portfolios with their mission and/or stakeholder interests. Questions are being asked about the long-term sustainability of 'growth' capitalism and asset owners are targeting solutions to environmental and social problems as well as financial returns through their investments. As an example, the focus on climate change is directly impacting portfolios as many investors look to reduce their exposure to carbon risk and invest in new technologies.

Until recently, one of the main impediments to the further growth of impact investment had been a lack of aggregated performance data. It was to address this problem that we, together with the GIIN, launched the Cambridge Associates Impact Investing Benchmark. Our purpose was to provide investors with credible data on risk and return to help them better identify strategies that suit their objectives.

Features of the benchmark

The Impact Investing Benchmark, which was launched in June last year, focuses on private equity and venture capital funds with an objective to achieve market rates of risk-adjusted return and an intention of having a social and environmental impact.

The benchmark is by no means perfect, since the sample size for this evolving market remains small. However, it represents an important first step, and as the industry matures, the dataset will become more statistically significant, providing an invaluable source of data on risk and return.

There are several notable features of the funds in our Impact Investing Benchmark. They tend to be small – just over half of the funds analysed raised less than $50 million. Also, they tend to be relatively young – over two-thirds of the funds analysed were launched in 2005 or later.

From a geographic and sector perspective, more than 50 per cent of the total assets of the funds have an exclusive focus on Africa, while over one quarter of the capital invested is focused on the financial services industry, reflecting the historically strong investor appetite for microfinance funds.

The investment themes include microfinance, employment, economic development, sustainable living, agriculture and education. Some 70 per cent of the funds have exposure to multiple themes, with the remainder pursuing a single theme.

Impact funds can make 'market-rate' returns

The headline finding is that *market-rate returns can be achieved*. It is a common misconception that investing for impact necessarily results in a below-market or 'concessionary' return. However, the Impact Investing Benchmark, which analyses funds launched between 1998 and 2010, demonstrates that strong financial performance is achievable. In fact, funds launched between 1998 and 2004 – those that are largely realised – outperformed funds in the comparative universe (which comprises non-impact funds). Over longer-time frames, the results are less compelling on an aggregated basis, with impact funds launched from 1998 to 2010 delivering a pooled return of 6.9 per cent (all figures represent net internal rates of return), falling short of the 8.1 per cent delivered by the comparable universe. It will be interesting to see if this picture changes as the dataset evolves and the younger funds are fully realised.

The strongest performers were the Emerging Market (EM) and smaller funds. EM impact funds returned 9.1 per cent to investors versus 4.8 per cent for Developed Market impact funds, while those focused on Africa performed particularly well, returning 9.7 per cent. Funds that raised under $100 million returned 9.5 per cent to investors, significantly outperforming similar-sized funds in the comparative universe (4.5 per cent). The larger impact investment funds (with assets of more than $100 million) underperformed the comparative universe. This raises the question of whether impact funds can deliver market rate returns beyond a certain scale – but given the small dataset, it is unfair to form hard conclusions at this stage.

Conclusion

We believe that the Impact Investing Benchmark represents an important step in advancing investors' ability to measure and evaluate the performance of impact funds. We are confident that it will help remove a key barrier to the growth of impact investing, and that the usefulness and applicability of this data will continually increase as the sample size grows and its track record develops.

One thing is very clear – impact funds can perform in line with top quartile non-impact funds but investors need to be aware of the significant dispersion between funds and dedicate appropriate resources to the selection process. Picking the right funds is critical for success.

Naomi Friend *is a Managing Director in Cambridge Associates' London office. She specialises in advising clients in Europe and the Middle East on investment strategy and portfolio management. Naomi is a member of Cambridge Associates' Mission Related Investing team, which supports clients to align their investment portfolios with environmental, social and governance concerns.*