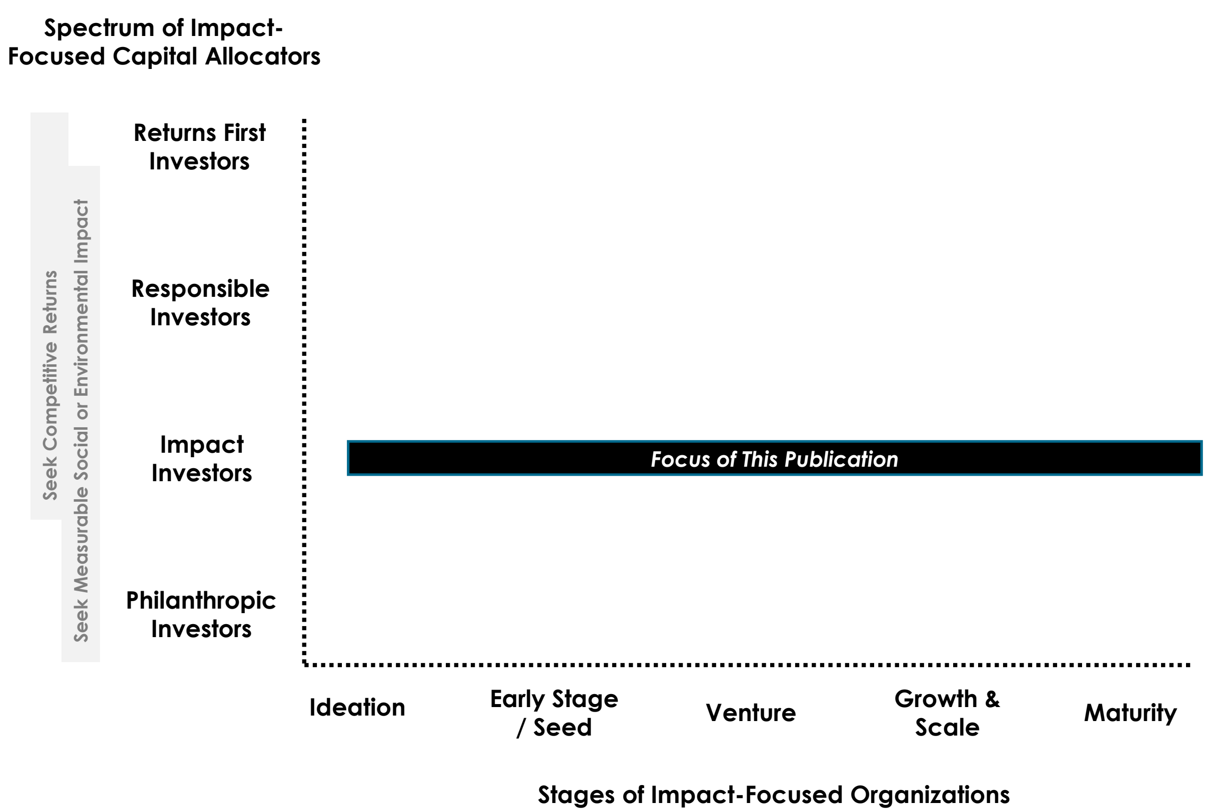
THOUGHT

Can you have your cake and eat it too?

"I care about maximizing BOTH social / environmental impact and financial returns. Generating just one of these things can be hard enough at times – so generating both sounds even more difficult! I want to find better ways to invest for both. I want to understand if I need to make trade-offs on one or the other to achieve my total investment objective."

*– an anonymous **Impact** investor*

Global impact investment assets continue to grow rapidly, and more investors want their capital to be managed in a way that aligns with their values – achieving BOTH financial returns and social / environmental impact. Achieving just one of these has provided investors with plenty of challenges, and so their skepticism towards achieving both is fair. In this paper, we question the notion of whether impact investors always must always make trade offs on financial returns or social / environmental impact to ensure the other goal is maintained.



Let's start with definitions and context
Impact Investors allocate capital to any organization whose primary objective is measurable social or environmental impact, alongside a financial return

Impact Investing is an approach to investing that intentionally seeks to have a positive social and/or environmental impact while also generating a financial return. Within impact investing lies a spectrum of strategies that are well worth understanding (Appendix 1)

We find impact investors can be defined along a spectrum of investment objectives – some who come at it from a returns-first angle, and those who come at it from an impact-first angle. Anecdotally, we find it common amongst investors to debate is optimizing for both financial returns and social / environmental impact invariably causes a tradeoff between the two

How do we consider trade-offs between financial returns and social / environmental impact?
For discussion purposes, we use a term "No Trade-Off" Investors: a subset of impact investors that seek to identify investment opportunities & strategies that

- Provide quantifiable, measurable social or environmental impact
- No trade-off on financial returns (returns are in-line with market rates for that asset class

Optimizing for just one of these factors can be hard enough - and so investment managers need to constantly find innovative ways to maximize both and capitalize on the growing demand for impact investment products and strategies

How can you work to avoid trade-offs on financial returns if you're focused on social or environmental impact?
Impact investment strategies need to be developed with a total framework and process that has the same level of rigor as traditional investment strategies – and they can be.

- Impact-focused capital allocators need strategies, processes, and investment due diligence conducted at the same rigor as traditional investment strategies, to help avoid the notion of a trade-off at all (Appendix 2)

- It can be informative to study an application of this rigor to the Canadian impact investment landscape and how it can be used to unearth attractive opportunities for financial returns (Appendix 3)

How can you work to avoid trade-offs on social and environmental impact if you're focused on financial returns?

1. Question the notion of a trade-off

- It's helpful to question the notion of a "trade-off" altogether – investors perceive there must be a trade-off. If they are solely focused on financial returns, they must trade-off on social and environmental impact

- This notion is not necessarily the case. If investors properly understand the business case of investing for impact, its clear that over time forgoing social and environmental impact for the sake of financial returns is not what the future holders of capital want. North America is witnessing the largest intergenerational wealth transfer in its history. The millennial heirs of this wealth reward companies with their investing and their spending when companies develop robust strategies for social and environmental impact (Appendix 4).

2. Focus on impact measurement to ensure accountability to social and environmental impact

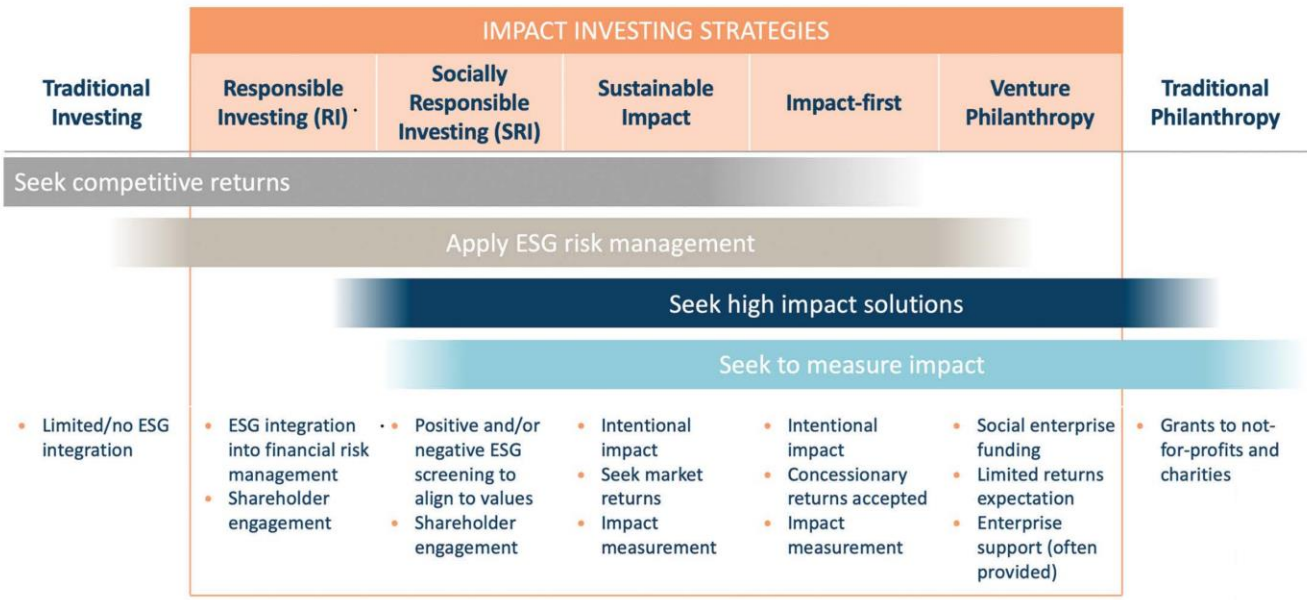
- Impact-focused capital allocators should focus on impact measurement strategies now – measurement is top-of-mind for investors (Appendix 5) who genuinely care about ensuring impact is being created and quantified

- Measurement is not easy, but difficulty is not an excuse. Whether you are a philanthropic investor, impact investor, responsible investor or returns-first investor – you can develop an approach to begin measuring the impact of your capital

Appendix 1

Impact Investors allocate capital to any organization whose primary objective is measurable social or environmental impact, alongside a financial return

Impact Investing is an approach to investing that intentionally seeks to have a positive social and/or environmental impact while also generating a financial return. Within impact investing lies a spectrum of strategies that are well worth understanding (Appendix 1)



Using the investment spectrum from Rally Assets Impact Investing Guidebook provides further visual context about the differences between responsible investment strategies and other impact-focused strategies

Appendix 2

Key Takeaway: Avoiding the notion of a financial returns trade-off must begin with a focus on:

1. **Impact Investment strategies & processes**
2. **Due Diligence on impact-focused opportunities &**
3. **Branding and positioning to attract capital, talent & scale**

that are approached with the same rigor as any traditional investment opportunity

How do you go about building your impact investment strategy this way?

1. Impact Investment Strategies & Processes

- **Strategy and Design:** Design impact investment strategies and processes for your firm based on your values, investment philosophy, impact and return requirements.
- **Product / Fund Creation & Process:** Creating structures & investment processes for all forms of impact funds in the same manner you would for traditional public equity, fixed income, private equity or venture capital funds
- **Deploy and Manage Capital:** Asset allocation, oversight and management of assets, reporting and portfolio rebalancing functions can be akin to traditional investment structures from the perspective of financial returns

2. Due Diligence on Impact-Focused Opportunities

- **Returns-Focused / Buyside Due Diligence:** Valuation, Investment Research, Confirmatory Due Diligence (industry study, competitive landscape etc.), Business Model Assessment and investment thesis development needs to be done similarly to best-in-class investment research firms
- **Focus on finding attractive deal flow:** Like any traditional investment fund, the best investment opportunities are by definition – scarce. Having a deal / investment sourcing function for an impact investment fund can't be

3. Branding & Positioning

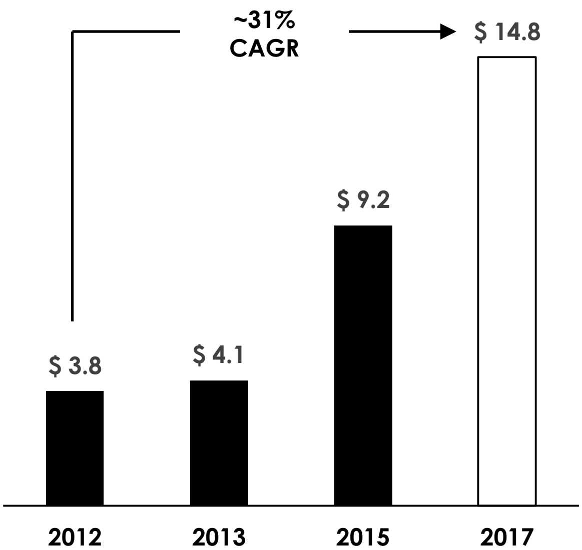
- **Impact Branding and Positioning:** Reporting and storytelling the impact your portfolio is having to attract more investible capital / funding, **recruit & retain aligned talent** and share the impact your capital is creating

Bottom line – avoiding a trade off on financial returns begins by creating your investment research functions with the same returns-lens as you would in a traditional investment research function

Appendix 3 - page (1/2)

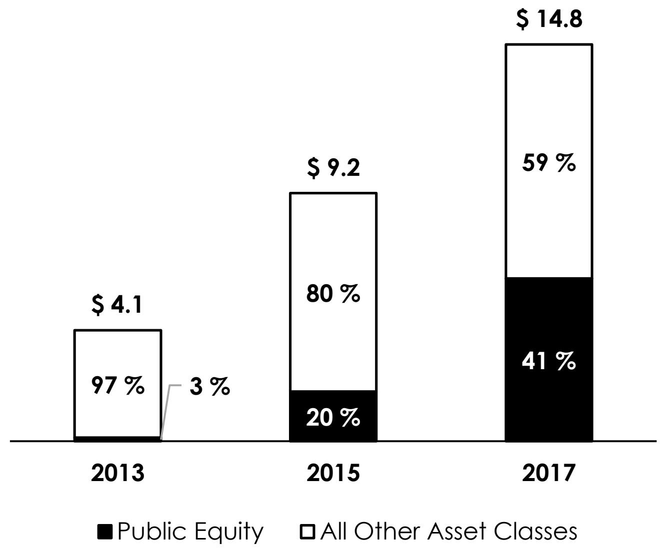
A Case Study: In Canada, Impact Investing AUM is growing rapidly, but it is over-indexed to public equity and dominated by the resource sectors, leaving a small universe of non-resource impact investments available

1. AuM Invested in Impact Investing in Canada continues to grow rapidly
(C$ in billions)



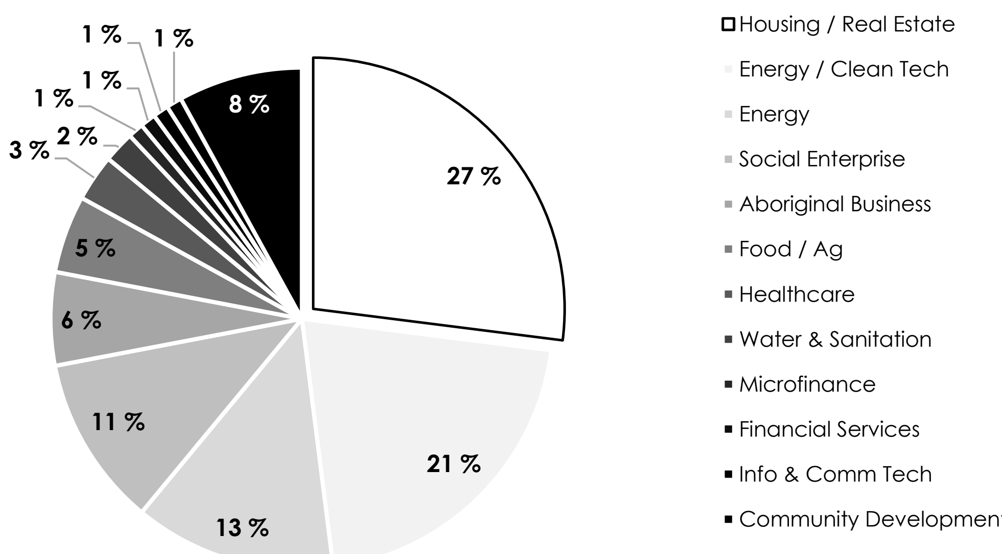
Source: Responsible Investment Association, 2018 Canadian Responsible Investment Trends Report

2. Over indexed to Public Equity: ~41% of Impact Investing AuM having grown from just 3% in 2013
(C$ in billions)



Source: RIA Canadian Impact Investment Trends Report, Responsible Investment Association

3. Impact Investing AuM allocation by sector - dominated by resource sectors, leaving a relatively small universe of non-resource companies available for investment
(C$ in billions)



Source: RIA Canadian Impact Investment Trends Report, Responsible Investment Association

Appendix 3 - page (2/2)

Hypothesis – There are an insufficient number of high-quality public equity investment opportunities in Canada

We find it highly unlikely that the supply / growth of high-quality public companies exists to match the demand / growth in public assets being managed for impact. Consider the following Thought process:

- The universe of Canadian public investment opportunities has been shrinking rapidly – corporate listings on the TSX have declined 30% since 2008.
- According to the RIA there is $2.13T in assets under management in Canada that technically count as "responsible investments" – this is approximately 50% of total investible AUM
- Canadian stock markets are largely dominated by resource sectors, leaving a relatively small universe of non-resource companies available for investment
- If you seek to apply a disciplined investment process that rigorously filters quality companies, the true investible universe becomes even further limited – we have dealt with this challenge in a very real way, given the experience in public equity analysis of our Founders
- While more companies are reporting on impact factors, and companies that are qualifying as impact investments are certainly increasing, our own experiences in Canadian public equity analysis suggests there are not enough impact investments that would provide a market return to investors

Implied Opportunities
Insufficient supply but growing demand for public equity impact investments creates scarcity value. This **creates large opportunity for growth / private equity impact-focused investments in Canada**, due to the growing number of venture-impact opportunities and related infrastructure that exists. We summarize our assessment of the impact investment infrastructure in Canada below

Venture
Revenue generating organizations looking to scale their operating model – typically seeking venture capital (or venture philanthropy for not-for-profits) to scale faster

- ✓ Rapid growth rate in impact start-ups and early-stage / venture funding
- ✓ Established impact-investment accelerators and marketplaces for funding

Growth & Scale
Well established organizations seeking growth/private equity or private funding to deliver impact at scale while meeting their return requirements

- ✓ **Funding & Infrastructure gap around growth/private equity impact investing**

Maturity
Organizations that have reached scale and are seeking strategies & capital to harvest and optimize their operating model to keep delivering social & financial returns at scale

- ✓ Rapid growth of investment demand
- ✓ Unlikely to be sufficient investment supply

Appendix 4 – (page 1/2)

Key statistics on the largest intergenerational wealth transfer in North American history

- In Canada - According to Strategic Insights, between now and 2026, an estimated $1 trillion of wealth will be transferred from baby boomers to their heirs (millennials)

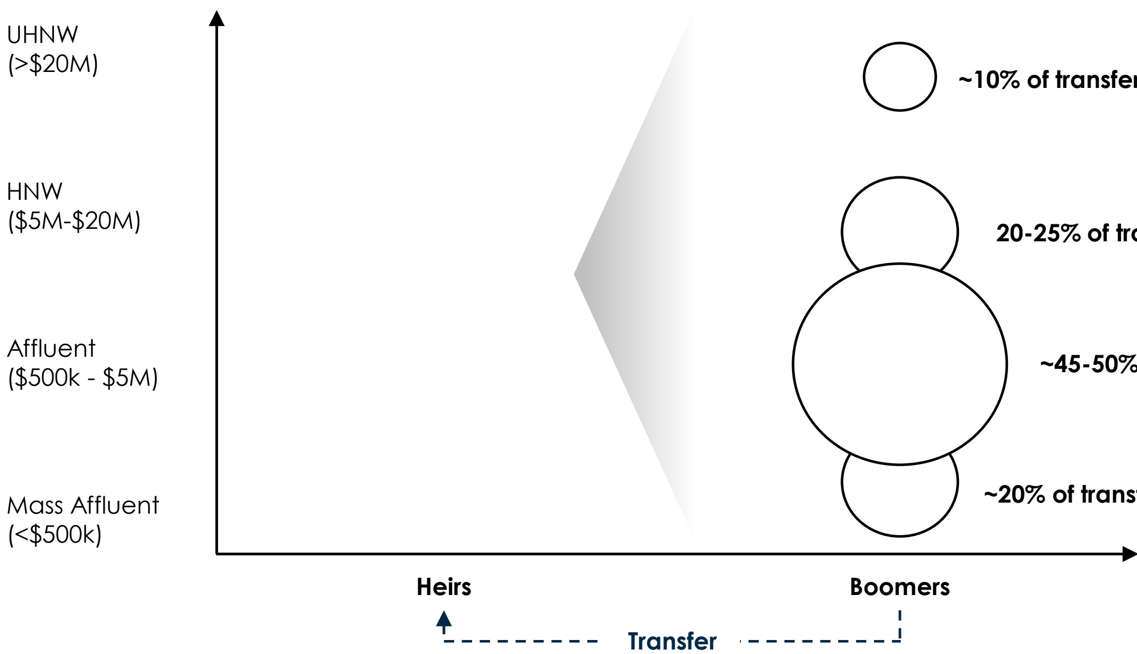
  Source: *Strategic Insights*

- In North America – According to over $31 Trillion in assets will pass from baby boomers to their heirs over the next 30 years

  Source: *Strategic Insights*

- The majority of the shift will come from affluent baby boomers, directly to affluent millennials

  Figure: Expected asset transfer from Boomers to Heir by major affluence cohort
  (% of wealth transfer)



Source: Accenture, The "Greater" Wealth Transfer (for transfer distribution applied to Canadian $1 trillion transfer), Wealth Engine data and Coldwell Banker data (for transfer distribution applied to North American $31 trillion transfer)

- When assets change generations, asset managers typically lose 70% to 80% of those assets

  Source: EY – Sustainable Investing: the millennial investor

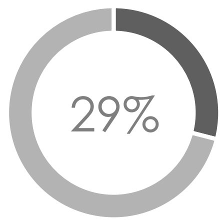
Takeaway
The largest intergenerational wealth transfer in North America is going to put power in the hands of millennials and their opinions on investment products will (i) matter (ii) break many traditional investment norms. Not understanding their investment preferences could lead to **missed investment opportunities and a loss of assets under management**

Appendix 4 – (page 1/2)

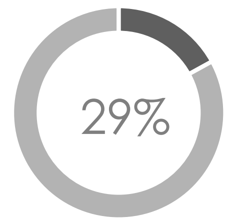
What is causing the growth in impact investing?
This growth is being driven by the largest intergenerational wealth transfer in North American history…and the recipients of this wealth care about investing for both financial and social returns

- $31 Trillion in assets will pass from baby boomers to their millennial heirs over the next 30 years – and it has the power to change many traditional investment norms
- These millennials are 2x as likely to factor social investment criterion in their investments than baby boomers were and their interest is driving (a) where they invest their money and (b) where they spend their money

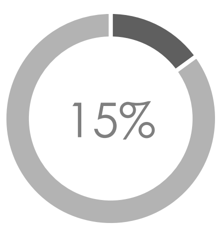
Millennials are 2x more likely to factor in sustainable investing criterion in their investments than baby boomers



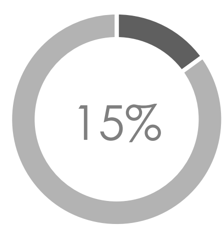
of investors in their 20s and 30s seek a financial advisor that provides values-based investing. Millennials rank this priority third in a list of nine identified priorities



17% of millennials indicate they seek to invest in companies that use high quality ESG practices, compared with 9% of non-millennial investors



of millennials indicate they would exit an investment position due to objectionable firm activity, compared with 7% of non-millennial investors



of millennials indicate they would rather purchase products from a sustainable brand, compared with 7% of non-millennial investors

Key Takeaways: Consumers wont let companies sacrifice on the social and environmental impact of their business models

Appendix 5

Why should measuring impact matter?

Impact measurement has been written at in such great length and is one of the major topics being brought to light in discussions that relate to social and environmental return.

Reiterating the work of hundreds of experts, we provide a succinct summary of our view on measurement and a simple framework to get you to think about how to measure impact. We also provide extensive and rigorous impact measurement content produced by industry authorities.

1. The Importance of Measurement
Social impact is difficult to define, creating potential for scarce resources (capital and human capital) to be deployed into programs that are not truly creating impact; given the volume of capital and resources that not-for-profits are using, there is a heightened desire amongst funders for:

- A need for quantified outcomes and tangible results vs. subjective articulations of the social and environmental impact
- Accountability from the not-for-profit sector to measure results
- Awareness of the efficacy amongst programs and ability to compare similar initiatives
- A case for support for funders to prove that organizations are delivering impact

2. What Happens When we Don't Measure Impact
- Greenwashing / Blue Washing: Enterprises with emotionally driven marketing and collateral and measurable, results driven programs are funded over organizations that are not creating measurable value for society
- The underlying objective of your capital (a positive social or environmental return) is often not met

3. The Difficulty in Measurement
How do we define "doing good", or "social impact"? Even if defined reasonably well, tying impact outcomes to financial values is challenging due to the number of stakeholders affected. As a general statement, the not-for-profit sector lacks quality data infrastructure to track impact, and established methods of measurement are criticized for some level of required subjectivity.

4. Difficulty is Not An Excuse
The challenges in measurement is not an excuse for us to ignore impact measurement. Whether you are a philanthropic investor, impact investor, responsible investor or returns-first investor – you should develop an approach to measure the impact of your capital.

Opportunities for growth and learning:

- **Rally Assets Impact Approach:** A complete and rigorous analysis process rooted in the UN's 17 Sustainable Development Goals (SDGs) – learn more here

- **Measuring Social Impact – A Crash Course:** A handy crash course by Donorbox that is instructive for organizations or funders who are thinking about impact measurement for the first time – learn more here:

- **A Measurement Suite – National Council of NonProfits**: A wealth / repository of measurement resources curated by the National Council of NonProfits in America that are very much applicable to all impact investments – learn more here: