

THOUGHT

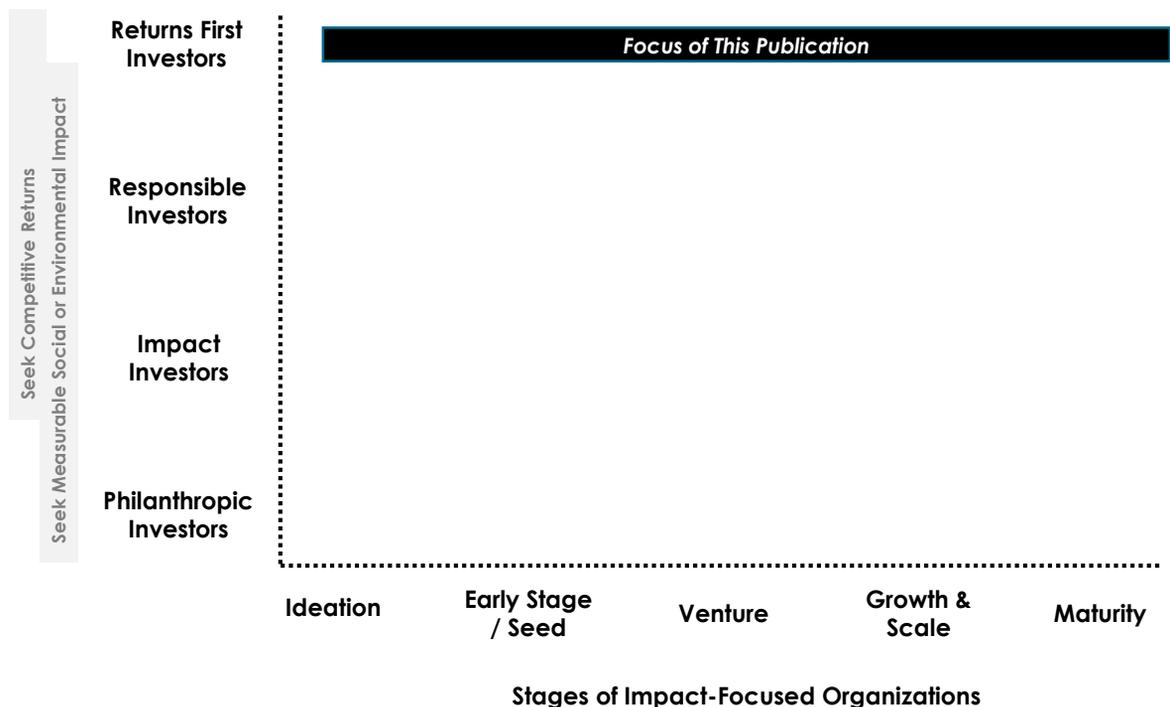
The business case of investing for good

"Social Investing? Isn't that a paradox? Isn't the goal of investing to maximize returns? Shouldn't we be ensuring our families earn the required return they need to retire...it's not practical or sustainable to expect families to trade off returns, nor is it practical to actually balance social and financial returns at the same time!"

– an anonymous traditional **Returns-First** investor

Whether you're new to "investing for impact" or simply skeptical of its practicality, the industry is too big and growing too fast to ignore any longer. It's time for all investors to understand the business case of social investing and strip through the myths. When you probe into the reasons for its growth, it's easy to see that consumers care about supporting businesses & investments that provide more than just profits. This paper focuses on showing you how these consumers are [showing this support with both their investments and their spending](#), and how investors should be reacting.

Spectrum of Impact-Focused Capital Allocators



The growth is difficult to ignore

Whether you're new to the space or simply skeptical, the trends are impossible to ignore. The growth of the "social investing" industry warrants your attention

- The North American demand for impact-focused investment products has grown rapidly – far faster than traditional investment demand – and is now an integral part of the investment industry (Appendix 1)

What is causing the growth?

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 in North America – and it has the power to change many traditional investment norms (Appendix 2)
- 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 (Appendix 3)

This interest is beginning to translate into direct business benefit

Asset growth is a good proxy for interest in social investing, but we are beginning to see direct financial benefit to businesses who are socially conscious

- Industry experts are starting to see correlations between margin performance and strong performance on environmental, social & governance (ESG) factors, as well as a rise in valuation premiums for companies within ESG topics as well (Appendix 4)
- Tracking the progress of margins & valuations of these impact-focused companies is critical to the sustainability of this industry in the long term, and the early signs are promising. We'll be watching these trends closely.

How do you act on the business case?

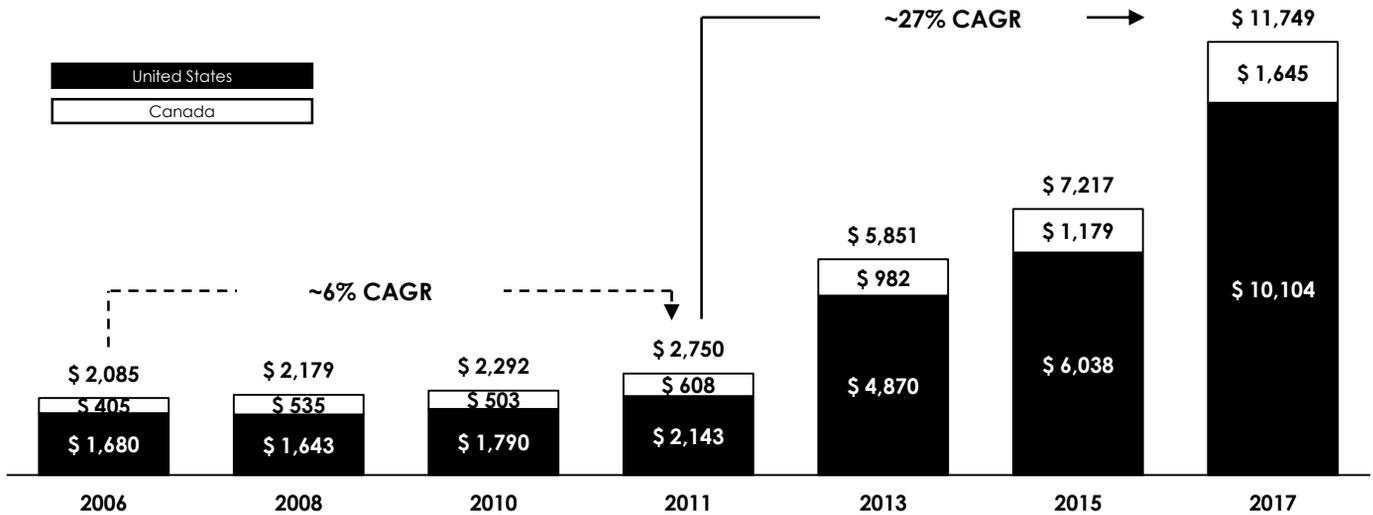
Depending on your previous experience in investing for impact, your size of fund, or stage of your investment strategy, any or all of the following next steps may apply – [contact us to learn more](#).

1. Educate you / your team on impact investment: Quickly learn about the various subsegments, trends and opportunities in these fields. We provide plenty of education material for investors available (Appendix 5)
2. Develop an approach to product strategy & design: Design impact investment strategies and processes for your firm based on your values, investment philosophy, impact and return requirements
3. Determine your investment structure: Consider structures & investment processes for all forms of impact funds including: ESG, SRI, Impact Private Equity Funds, Venture Capital, Venture Philanthropy, Foundations, Donor-Advised Funds based on your firm's strategy & design
4. Determine your capital management approach: Consider your asset / impact allocation, impact measurement approach, governance and portfolio management approaches
5. Determine your due diligence approach: Develop an investment process considering all aspects of impact (e.g. measurement) and returns-focused diligence (e.g. valuation, investment research, confirmatory due diligence etc.)
6. Consider branding: Establish a reporting and communications strategy to properly position your brand to attract more investible capital, recruit aligned talent, and share the impact your portfolio is creating

Appendix 1

1) Rapid growth in North American assets under management (AUM) using at least some form of responsible or impact investment strategy

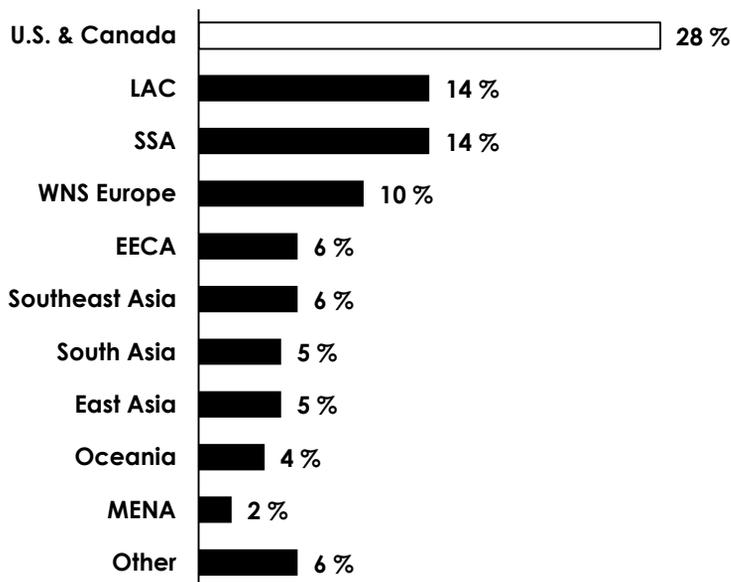
(US\$ in billions)



Source: Responsible Investment Association; 2018 Canadian Responsible Investment Trends Report, US | SIF, Report on US Sustainable, Responsible and Impact Investing Trends 2018

2) Geographic distribution of Impact Investing AUM

(As a % of total investment AUM)



Source: Global Impact Investing Network, 2019 Annual Impact Investor Survey

3) Key Statistics Worth Referencing & Understanding

- Global Impact Investing AUM growing at ~34% a year since 2016¹.
- The combined rate of growth of responsible or impact investment growth is 85% growth since 2014 vs. 28% growth for traditional AUM in North America²
- In addition to rapid growth, the Impact Investing market offers legitimate scale, with US\$502B in AUM internationally².

¹ The Forum for Sustainable and Responsible Investment, 2018 Global Sustainable Investment Overview

² Global Impact Investing Network, Sizing the Impact Investing Market (2019)

Takeaway

The growth in assets under management (AUM) focused on “social investing” is growing rapidly and much quicker than traditional returns-only AUM. North America in particular has seen the most AUM market penetration to-date. The industry as a whole has size, scale and growth and has become too big to ignore.

Appendix 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)

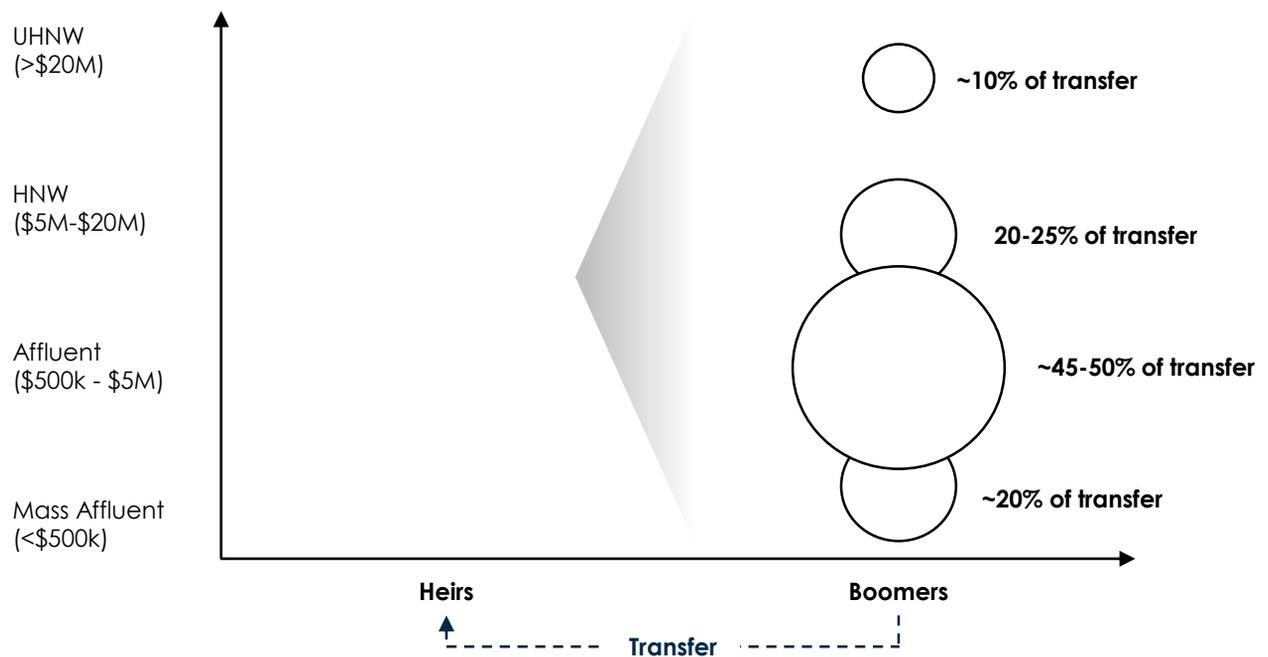
Source: Strategic Insights

- 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

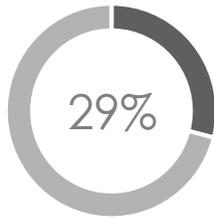
The largest intergenerational wealth transfer in North America is going to put power in the hands of millennials and their opinions on investment products will (i) matter (ii) break many traditional investment norms. Not understanding their investment preferences could lead to **missed investment opportunities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

Appendix 3

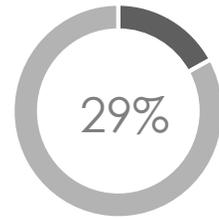
Key statistics on millennial sentiment and predisposition towards investing for both financial and social returns



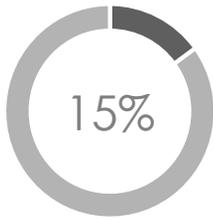
Millennials are 2x more likely to factor in sustainable investing criterion in their investments than baby boomers



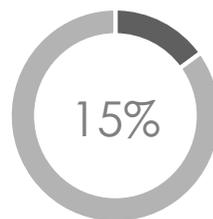
of investors in their 20s and 30s seek a financial advisor that provides values-based investing. Millennials rank this priority third in a list of nine identified priorities



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

Source: Next Avenue, EY – Sustainable Investing: the millennial investor

Takeaway

Millennial interest and predisposition towards investing for both financial and social returns is near double that of non-millennial investors. This is driving (a) where they invest their money and (b) where they spend their money as we explain in more detail within Appendix 4

Appendix 4

1) Margin premiums are linked to strong performance in ESG topics – companies who perform well in ESG topics are earning better industry margins than their industry peers who aren't



Consumer Packaged Goods

Conserving Water

3.1 pp EBITDA
5.5 pp Gross profit

Ensuring a responsible environmental footprint

1.3 pp EBITDA
3.3 pp Gross margin

Limiting negative effects on biodiversity and ecology

3.0 pp EBITDA

Minimizing impact of products and packaging

4.1 pp EBITDA
12.4 pp Gross margin

Socially responsible sourcing

4.8 Gross margin



Biopharmaceuticals

Conducting ethical human clinical trials

6.1 pp EBITDA
6.3 pp Gross margin

Expanding access to drugs

8.2 pp EBITDA
6.7 pp Gross margin

Promoting transparent lobbying

5.1 pp EBITDA



Oil and Gas

Maintaining process-oriented health and safety programs

3.4 pp EBITDA

Supporting ongoing employee training

8.2 pp EBITDA
6.3 pp Gross margin



Retail and Business Banking

Avoiding and combating corruption

2.3 pp Net income margin

Ensuring fair debt collection

0.5 pp Net income margin

Ensuring fair selling practices

0.4 pp Net income margin

Environmentally responsible sourcing

3.4 pp Net income margin

Promoting financial inclusion

0.5 pp Net income margin

Source: Boston Consulting Group, Total Societal Impact (2017)

2) Higher valuations are linked to strong performance in certain ESG topics



Consumer Packaged Goods

11%

Valuation Premiums



Biopharmaceuticals

12%

Valuation Premiums



Oil and Gas

19%

Valuation Premiums



Retail and Business Banking

3%

Valuation Premiums

Source: Boston Consulting Group, Total Societal Impact (2017)

Takeaway

Industry experts are starting to see correlations between businesses' margins and valuations and their performance on certain ESG topics, relative to their peers. For us, tracking the progress of margins & valuations of these impact-focused companies is critical to the sustainability of this industry in the long term, and the early signs are promising

Appendix 5

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. At Thought, we find it helpful to understand impact investing by approach it from an investor-segmentation lens - which we call "Impact-Focused Capital Allocators".

Our spectrum of Impact-Focused Capital Allocators

Seek Competitive Financial Returns

Seek Measurable Social or Environmental Impact

Returns-First Investors

Investors who purely seek to maximize financial returns

Responsible Investors

Investors who avoid irresponsible companies and/or seek companies that actively integrate responsible business practices (e.g, ESG, SRI Investments)

Impact Investors

Investors who allocate capital to any organization where their primary objective is measurable social or environmental impact alongside a financial return

Philanthropic Investors

Investors who allocate capital with the sole purpose of maximizing social or environmental impact, with no financial return

Why Do We Define It This Way?

We look at all types of capital that could be used to create a social or environmental return as one huge pool of capital that could be used to solve some of society's largest problems

Detailed publications elaborating on trends and opportunities for each segment can be found on our [website](#)