6 Key Questions About Impact Investing

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by Eric Rice

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Impact investing is often conflated with sustainable and environmental, social and governance (ESG) disciplines. Yet it's quite distinct. We spoke with Eric Rice, an active equity portfolio manager and impact investing pioneer, to learn more.

What is impacting investing?

Impact investments have a dual mandate: They seek to generate positive, measurable social and environmental impact alongside a financial return. Impact investing comes with a specific intention and necessitates that investments be managed toward that intention. We like to say impact companies are looking to solve the world's greatest problems.

How does impact differ from ESG investing?

ESG is about how a company any company operates. Is it good to its environment? Is it good to its stakeholders? Does it have good governance? Any company, no matter its business, can be a great ESG company.

An impact company, in contrast, is specifically making goods and services aimed at solving important environmental and social problems. Whereas ESG is about *how* companies go about doing what they do, impact investing is about *what* they do.

What types of problems are impact companies aiming to solve?

A key guide for impact investing is the United Nations Sustainable Development Goals (UN SDGs). Some of the problems they seek to tackle are poverty, hunger, education, inequality, clean water and sanitation, clean energy, climate action and more. We look not to the 17 UN SDGs, the goals, but to the SDG targets, of which there are 169. We believe these reveal where the problems really are.

How do you screen for "impact"?

We want companies that are advancing solutions to problems, and we look at a few criteria to assess that. The first is materiality, meaning a company's core business is creating impact. A company that is dabbling in do-good, but at the same time making chairs or steel like any other company, would not qualify as "impact."

The second consideration is that the company be additional. This means the goods and services on offer should represent a new technology or a new business model, or the company should be bringing those goods to a population that hasn't had them before. It's additional in the sense that if it weren't for that company and its efforts, some critical problem would be left unaddressed.

Who can invest for impact?

The opportunity to invest for impact is greater today than at any time before and accessible to a wider audience. The origins of impact investing trace to microfinance where small loans funded micro enterprises such as farmers and entrepreneurs in remote villages. Today, venture capital and private equity impact strategies play a big role in building impact businesses across industries and geographies. But there's a place for public equity markets as well.

With a long-term, ownership mindset, impact investors in public equities offer several benefits. They can provide the capital needed for impact companies to grow; engage with companies to enhance impact outcomes; increase the visibility of undervalued impact companies; and democratize access to impact investing.

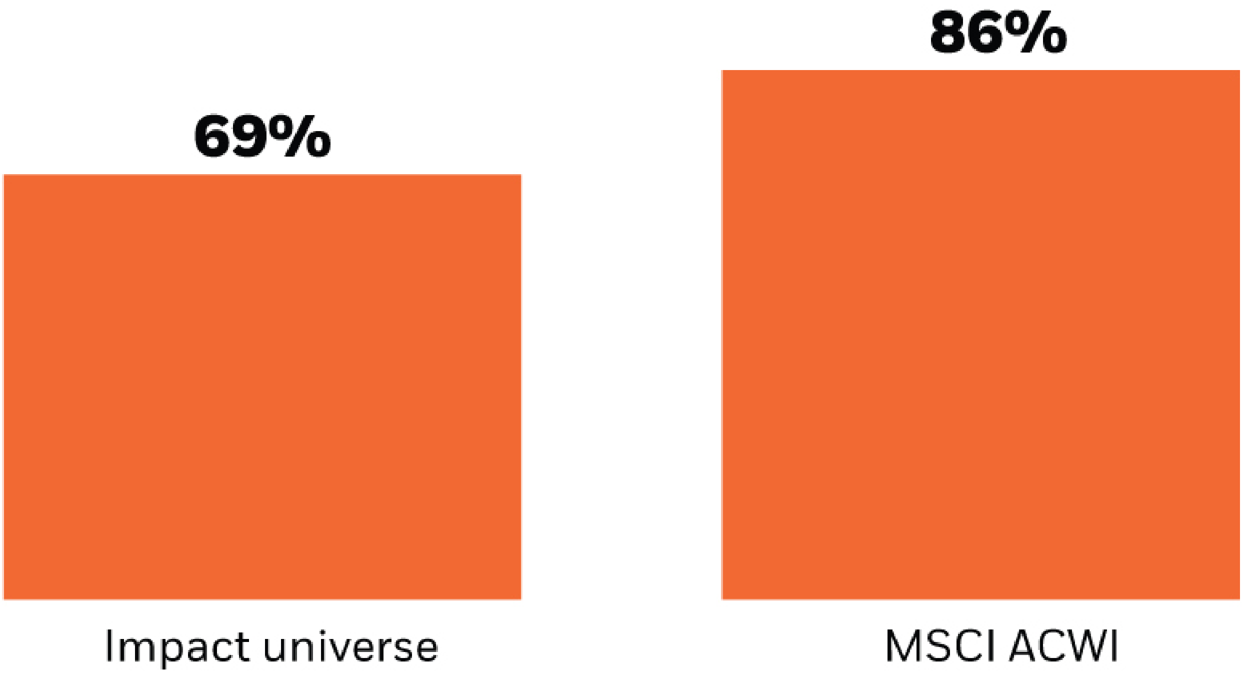
On that final point, how can individual investors participate?

Individual investors can access impact opportunities through pooled investment vehicles such as those we manage here at BlackRock.

We have developed a universe of nearly 800 impact companies in which we can invest. The number of companies in the universe continues to grow and currently represents over $7 trillion of market cap. Across these companies, we have set a very high bar for impact, such that the team can confidently look to this large and well-vetted universe and apply conventional stock selection and portfolio construction techniques. We believe this combination helps to ensure our shareholders can target their dual goals of doing well while doing good.

To note, impact companies generally have lower analyst coverage than global stocks broadly. By our count, only 69% of our universe receives diversified coverage compared to 86% of stocks in the MSCI ACWI. (See the chart below.) This suggests to us that impact enterprises are often overlooked and misunderstood, which we believe leads to frequent undervaluation and opportunity for growth.

Impact companies receive less attention
Percent diversified coverage by sell-side analysts



Source: BlackRock, with data from FactSet, March 2020. Chart shows sell-side analyst coverage of stocks in the MSCI ACWI Index versus BlackRock's proprietary universe of impact companies. "Diversified coverage" is defined by having more than five analysts covering a stock.

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