

The Emergence of Impact Investing as an Asset Class

by

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ABSTRACT

This study examines private equity (PE) and venture capital (VC) impact investments and their ability to produce financial returns that rival and even surpass the financial returns of traditional funds and comparative indexes. It will define impact investing as its own, viable asset class that produces a blended value of social impact and financial return. This study will use the PE/VC Impact Investing Benchmark created by Cambridge Associates in collaboration with the Global Impact Investing Network. This study will provide an analysis of the data from this benchmark that shows four main findings. First, the number of PE/VC impact investing funds founded each year is growing. Second, the 5-year returns for PE/VC impact investing funds have surpassed the 15-year returns. Third, the returns for PE/VC impact investing funds in both emerging and developed markets are competitive with, and even surpass, some of the returns of comparative indexes. Finally, PE/VC impact investing funds that were founded between 1998 and 2001 offer the highest returns compared to the 15-year returns of the comparative indexes. This study discusses the implications of these results regarding capital allocations and investors, as well as steps for future research on impact investing.

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INTRODUCTION

Impact Investing can be defined in terms of responsible investing. According to the *Journal of Sustainable Finance & Investment*, socially responsible investing (SRI) “takes environmental, social and governance (ESG) factors into consideration when making investment decisions” and impact investing is a subset of this in which the investor “intentionally invests to achieve social and/or environmental impact in addition to financial return” (Hebb, 2013). Hence, impact investors strive to allocate funds toward investments that both satisfy return requirements and are conducive to social or environmental provisioning.

Several asset classes contain impact investments, including private equity. In fact, impact investments can be considered its own emerging asset class (Hebb, 2013). Impact investing can also be referred to by the idea of the “triple bottom line,” which companies use to evaluate their performance in social, environmental and financial parameters. The term “triple bottom line” was coined in 1994 (Henriques, 2004). Since then, the focus on corporate social responsibility (CSR) and sustainable development (SD) in tandem with financial returns has taken off. O’Donohoe (2010) recognizes the potential for impact investments to “attract a larger portion of mainstream private capital and anticipates that more investors will seek to generate positive social and/or environmental returns when making investment decisions.”

Many argue that a strict focus on impact investing promotes an undiversified portfolio. Investors prefer a diversified portfolio over an undiversified, or restrictive, portfolio. According to *Accounting & Finance Volume 50, Issue 2*, socially responsible investing imposes non-financial screens which “restricts investment opportunities, reduces diversification efficiencies and thereby adversely impacts performance.” However, that study concluded that this non-financial screening intensity has no effect on unadjusted returns (Lee, 2010).

This paper will argue that impact investing has potential to rival the returns of traditional, non-impact funds while minimizing risk through diversification and maximizing the effect that portfolio companies have on solving both social and environmental problems.

LITERATURE REVIEW

Impact Investing Defined

Impact investments have two sides: positive social outcomes and financial returns. Impact investments “intend to create a positive impact beyond financial return” (O’Donohoe, 2010). Impact Investing is not to be confused with socially responsible investing (SRI). SRI takes ESG factors into consideration, but it “seeks to minimize negative impact rather than [to] proactively create positive social or environmental benefit” (O’Donohoe, 2010). Hebb (2013) describes impact investing as a subset of SRI where impact investing actively seeks positive ESG outcomes and maximum financial return. Emerson summarizes impact investing with the following:

Broadly speaking, impact investing has come to be defined as the active management of one’s portfolio of capital investments to obtain a level of financial return together with the creation of social and/or environmental impact(s). In a phrase, impact investing seeks to move from an “either/or” framework of asset management (wherein one either does good or does well) to a “both/and” investment approach that seeks both sound financial returns and the generation of positive social/environmental returns.

Batty (2015) describes impact investing as a divergence from “impact-first investors” who prioritize impact over profits. In impact investing, ESG impact is a criterion when making investment decisions but it does not take precedence over financial returns. However, impact measurement arises as an issue. While investors can easily measure returns quantitatively, investors cannot as easily measure impact. Issues arise particularly when attempting to measure impact between dissimilar investments. For example, “it doesn’t make sense to compare someone who is creating jobs on the South Side of Chicago with somebody who is trying to improve [worker treatment] in factories in Bangladesh... it is not a one size fits all process” (Batty, 2015). Batty also states that benchmarking is important and that creating asset classes of impact funds would make it easier to benchmark them against similar funds with regard to ESG impact. This would also simplify assumptions about risk and return, liquidity and timing. However, Hebb (2013) and O’Donohoe (2010) argue that impact investments are already included in different asset classes. In fact, O’Donohoe (2010) says that impact investing is emerging as its own asset class.

Impact Investments can be categorized into different investment classes and industries. Some of the most common industries containing impact investments are microfinance, energy, climate change, healthcare, sustainable development and education. Different asset classes containing impact investments include cash/cash alternatives, bonds, real estate, commodities and private equity (Emerson). Thus, impact investments span across a diverse range of industries and investment vehicles within both the public and private sectors.

The Emergence of Impact Investing

The idea of socially responsible investing is relatively new. John Elkington coined the term “triple bottom line (TBL)” in 1994 (Henriques, 2004). Elkington was striving to “measure sustainability during the mid-1990s by encompassing a new framework to measure performance in corporate America” (Slaper, 2011). “Triple bottom line” refers to three different metrics of performance review – social, environmental and financial. The social and environmental measures differ from what is normally measured in traditional performance evaluation framework. The “three P’s” – people, planet and profits – can be used interchangeably with the “triple bottom line” (Slaper, 2011). The use of the TBL as a performance metric has grown across industries since it was first introduced. Impact investing coincides with the TBL since the TBL not only strives to measure social and environmental impact, but financial performance as well.

In 2010, O’Donohoe predicted that the potential over the next ten years for impact investing was “invested capital of \$400 billion to \$1 trillion and profit of \$183 to \$667 billion.” This projection includes businesses within five sectors – housing, rural water delivery, maternal health, primary education and financial services – for the portion of the global population earning less than \$3,000 per year. Since impact investing can span across any investment that has both positive ESG outcomes and financial returns, it is safe to say that these projections are not completely accurate because of the restricted criteria. The potential for overall impact investing is most likely larger than predicted in that study.

O’Donohoe also describes impact investing as an emerging asset class and proposes that asset classes have the following characteristics:

- Require a unique set of investment/risk management skills,

- Demand organizational structures to accommodate this skillset,
- Serviced by industry organizations, associations and education,
- Encourage the development and adoption of standardized metrics, benchmarks and/or ratings.

Asset classes such as hedge funds and emerging markets, which channel significant capital flows, have these characteristics (O'Donohoe, 2010). Impact Investing deploys these characteristics and should thus be considered its own asset class.

As a response to impact investing's rapid emergence, many educational institutions are beginning to offer courses geared toward impact investing. For example, the University of Chicago Booth School of Business now recognizes both impact investing and venture philanthropy as standalone career paths and provides courses to help students learn more about these asset classes and the investment vehicles associated with them. The courses that Chicago Booth offers for this path of education include, but are not limited to:

- Impact Investing (BUS 34112),
- Scaling Social Innovation Search Lab (BUS 34722),
- Entrepreneurial Finance and Private Equity (BUS 35722),
- New Social Ventures (BUS 34115),
- Social Enterprise Lab (BUS 34110).

The recognition of impact investing by highly regarded universities speaks to the fact that impact investing is an emerging area of study and a viable career path. University creation of specific classes geared toward impact investing demonstrates that the subject is likely going to be a growing and long-lasting area of study. Chicago Booth also offers competitions, scholarships,

jobs, internships, work spaces, student groups and mentoring for students pursuing this path (Chicago Booth: Social Enterprise Initiative, 2016).

Universities also reveal their focus on impact investing through their endowments. In 2012, the Investor Responsibility Research Center Institute and Tellus Institute released a report on ESG investing by endowments including environmental and community investing and microfinance (IRRC Institute, 2012). Environmental and community investing and microfinance are commonly under the scope of impact investing (Steinbach, 2012). IRRC Institute (2012) lists some of the institutions that made notable community investments or investments in microfinance. These institutions include Duke University, Harvard University, Tufts University and the University of Louisville. Also, in 2012 Goshen College invested over \$100,000 of its endowment in MicroVest, a private, for-profit firm that makes debt and equity investments in microfinance institutions (IRRC Institute, 2012). Goshen college's investment in a for-profit firm with a focus on social impact is an example of the recent focus that institutions are placing on impact investing.

In addition to universities, many companies have begun to place a focus on social impact within their business models. For example, Bain & Company implemented a social impact unit that offers services such as pro bono public sector and sustainability case work and externships (Bain & Company, 2016). Many companies are placing an increased focus on corporate social responsibility (CSR). Most Fortune 500 companies publicizes their CSR initiatives on their company websites. These companies include Johnson & Johnson, AIG, Lockheed Martin, Eli Lilly and many more. Social impact and sustainability have become important parts of corporate business models and are arguably aspects that customers expect.

A number of financial institutions have entered the realm of impact investing. Notably, Goldman Sachs has an impact investing unit called the Urban Investing Group. This group has committed about \$5 billion to “underserved American communities.” It focuses on community development, social impact bonds and financing for small businesses. Some of the development and revitalization projects it has supported include affordable housing construction, job creation, quality education, healthcare facilities and small business (Goldman Sachs, 2016).

Clearly, CSR has become increasingly important to both universities and businesses alike. However, it does not simply stop at philanthropic activities and charitable donations. Impact investing has been growing quickly, in part due to its financial returns.

Impact Investing vs. Diversified Portfolios

Analysts use two methods to consider impact investments within a portfolio. One way investors may view impact investing is as “a broad, strategic investment approach to asset management with each allocation being specifically assessed with an eye toward how it may contribute to the financial and impact performance of the total portfolio under management” (Emerson). In other words, the entire portfolio is made up of impact investments – each investment is analyzed based on both financial and impact performance. On the other hand, impact investments can be considered an asset class within an otherwise traditional, diverse portfolio. Regardless, risk, return and impact must all be measured and assessed when identifying potential investments.

Emerson discusses the different risks that investors are concerned with and several additional risks that are important to impact investors specifically. These risks include:

- *Liquidity risk*: This is the ease with which an investor can sell an investment.

- *Impact risk*: This is “the possibility that what may first be viewed as a ‘good thing’ may actually end up being ‘not so good’.”
- *Manager risk*: The impact space consists of shorter track records and turnover of staffing may be high.
- *Fund development risk*: There are constraints on the impact segment for raising and deploying capital.
- *Measurement and reporting risk*: There are difficulties to measuring impact. Investors seeking to maximize impact rather than financial returns may be exposed to an inaccurate assessment of impact.
- *Social enterprise risk*: This is “the type of underlying business venture that is linked to the investment vehicle and the level of risk carried by it.” It is similar to traditional enterprise risk, but the risk does not just relate to the successful execution of the business – it also relates to whether it will create the projected social and/or environmental outcomes.
- *Subordinate capital risk*: This is the reliance on grants or other subsidies.
- *Exit risk*: Since impact investment alternatives are smaller and more specialized, investors face challenges in realizing investment returns in the future.

Since many investors are not very familiar with the field or history of impact investing, investors must perform a higher level of analysis and due diligence to assess an impact investment. As a result, a low-risk investment may actually be written off as too risky (Emerson).

The flip side of the “risk” coin is return. Impact investments come within a large assortment of investment vehicles which “increasingly offer financial returns consistent for their asset class” (Emerson). However, many investors will redefine the “return” they are looking for,

meaning that they have a defined level of financial performance with a measureable social and/or environmental return, so the financial return may not be what the market deems appropriate (Emerson). Emerson also states that 39% of investors surveyed in the United Kingdom would consider accepting a “below market” financial return in exchange for social and/or environmental value creation potential. However, must this always be the case, or can impact investments rival the expected market returns of traditional diversified portfolios and other indexes? This study will provide evidence on this in the context of private financial institutions. Private companies, specifically private equity and venture capital firms, are riskier than investments in public companies, so they should provide higher returns.

Private Equity and Impact Investing

Private equity (PE) is a specific asset class that can contain impact investment options. Emerson lists some of the specific impact investment themes within private equity. These include clean tech venture capital (VC), energy efficient VC, water technology VC, community development VC, small and medium social enterprises, consumer product VC and education PE. Venture capital is a subset of private equity that focuses on start-up companies and making smaller investments that have an exaggerated amount of risk. In general PE is considered a risky investment, thus it is expected to provide high financial returns. PE is a popular form of impact investing because of the opportunity to invest directly into private companies or funds as opposed to investing in public companies; direct investment will possibly have a greater, more immediate impact than investing in publicly traded companies (Emerson). PE investments give the investor a potentially controlling interest or large stake in the given company and investors can choose to help make strategic decisions in order to create more ESG impact and financial

returns for the fund. These fund managers must have a thorough understanding of the types investments they are dealing with. However, the risks associated with these investments are higher than those associated with investments in publicly traded companies. Regardless, the goal is to maximize portfolio performance, that being the blended value of financial and impact performances. Impact investing is about “maximizing impact and creating a portfolio of investments that generates the greatest total returns possible for investors and stakeholders alike” (Emerson). So, can the returns private equity and venture capital impact investing funds rival the returns of traditional diversified portfolios and other comparative indexes?

METHODS AND RESULTS

Methods

Cambridge Associates, in collaboration with the Global Impact Investing Network (GIIN), launched the Impact Investing Benchmark in June, 2015. This benchmark is “the first comprehensive analysis of the financial performance of market rate private equity and venture capital impact investing funds” (Cambridge Associates, 2015, 2016). The first conducted study consisted of 51 private investment (PI) funds with the criteria that the funds were created with the intention to “generate social and environmental impact alongside a financial return” (Cambridge Associates, 2015, 2016). In order to be included in the study, the firms needed to target risk-adjusted market rate returns, rather than concessionary returns. This included “private equity and venture capital funds with a target net internal rate of return (IRR) of 15% or higher and mezzanine funds with a target net ITT of 10% or higher” (Cambridge Associates, 2015, 2016). The study consisted of funds throughout various impact themes, including:

- Financial inclusion,

- Employment,
- Economic development,
- Sustainable living,
- Agriculture,
- Education.

It also included funds in various industries, both emerging and developed markets, with vintage (founded) years between 1998 and 2010 and with fund sizes anywhere from \$1 million to more than \$200 million in total assets.

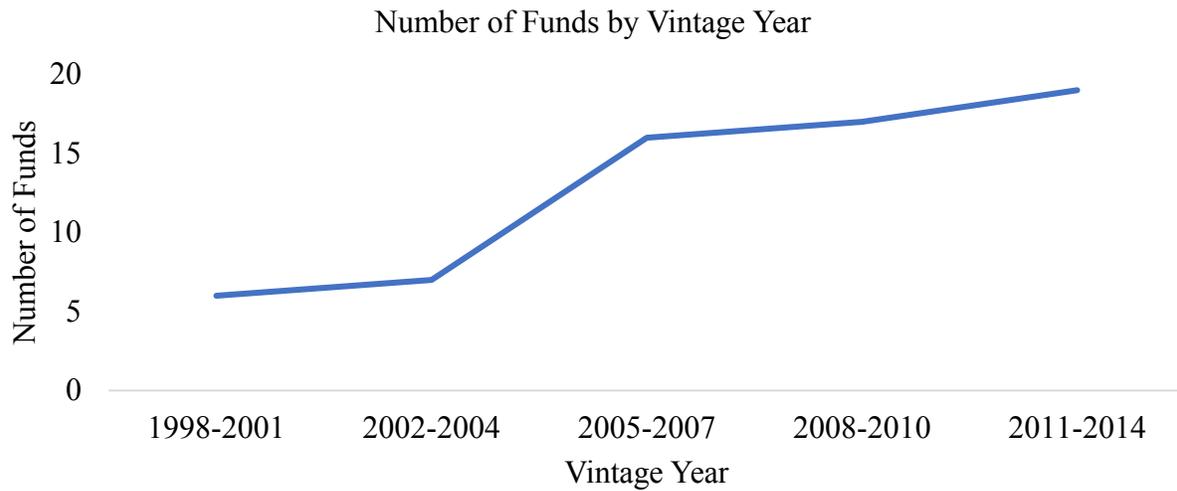
In the June 2015 study, Cambridge Associates and the GIIN found several trends with these impact investment funds, including:

- Impact investment funds that raised under \$100 million outperformed similar sized funds in the comparative universe,
- Emerging markets impact investing funds, especially those focused on Africa, performed particularly well,
- Market-rate returns are available in impact investing (Cambridge Associates, 2015).

Results

Cambridge Associates Associates and the GIIN continued this study in the following quarters, and by the third quarter of 2016, the study included 65 PI funds that fulfilled the same criteria of impact investing as the funds in the first study. This most recent study provided data on the returns of these funds by geography and vintage year. It also provided data on the returns from comparative indexes, such as the S&P 500 and the MSCI Emerging markets index. Figures 1 through 5 provide an analysis of the data provided by this study:

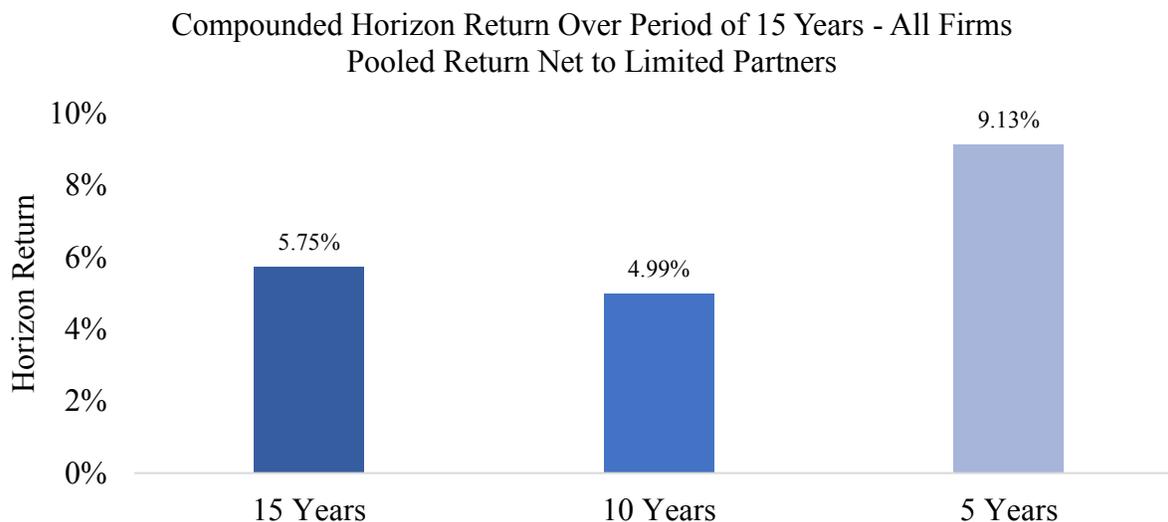
Figure 1



Source: Cambridge Associates, 2016

Figure 1 shows the number of funds in the study by vintage (founded) year. After 2004, the number of impact investing funds experienced a spike of high growth. Impact investing is a quickly growing area of investing, further supported by the data shown in Figure 1.

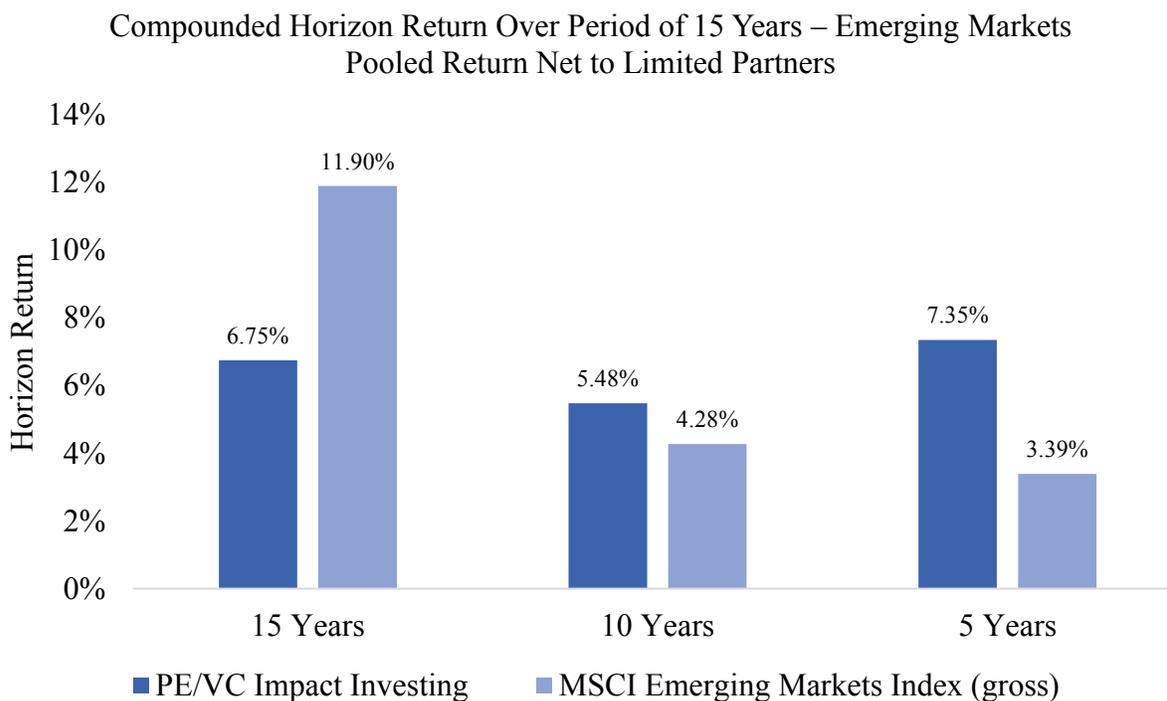
Figure 2



Source: Cambridge Associates, 2016

Figure 2 shows the compounded horizon return over a period of 15 years for all firms included in the study. This return is measured by each fund's pooled return net to limited partners. Cambridge associates states that the pooled return "aggregates all cash flows and NAVs in a sample to calculate a dollar-weighted return (minimum of 3 funds)" (Cambridge Associates, 2016). NAV means net asset value and it is the value of a fund net of its liabilities. Figure 2 shows that these funds have provided a 5-year return of 9.13% compared to a 15-year return of 5.75%, which exhibits substantial growth. As impact investing becomes more recognized and more research is done on this area of investing, managers are able to learn more about managing these types of funds and are better able to implement investment strategies that provide higher financial returns. This concept could be a significant reason for this spike in growth of the 5-year returns.

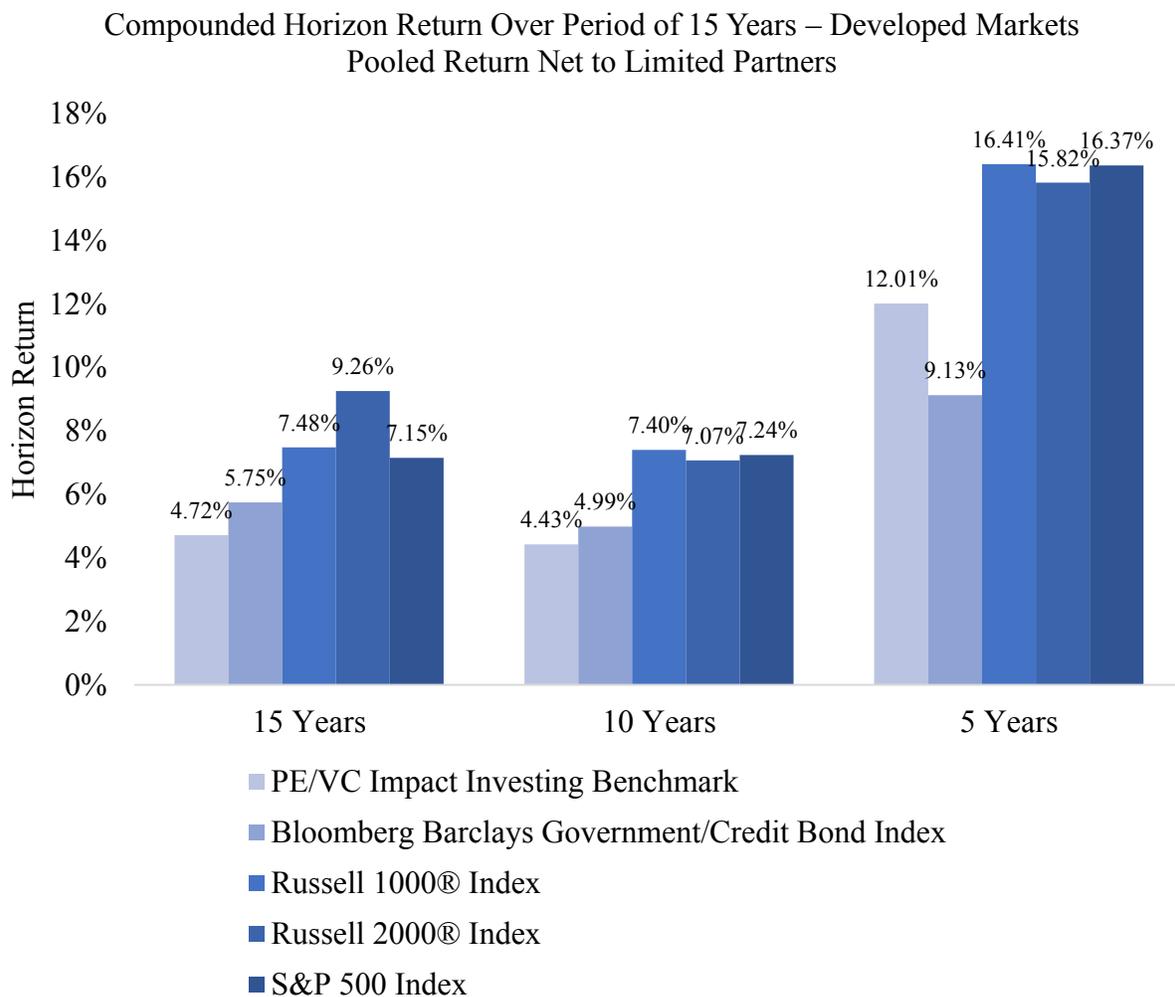
Figure 3



Source: Cambridge Associates, 2016

Figure 3 shows the pooled return over the past 15 years for emerging markets funds. These include emerging markets funds in Asia/Pacific, Europe, Latin America, the Caribbean and Africa. These returns are compared to the pooled returns of the MSCI Emerging Markets Index. The MSCI Emerging Markets Index “captures large and mid-cap representation across 23 Emerging Markets (EM) countries” (MSCI Emerging Markets Index, 2017). The index has 830 constituents. As seen above in figure 3, the returns for emerging markets impact investing funds have increased over the past five years and have surpassed the 5-year returns of the MSCI Emerging Markets Index.

Figure 4



Source: Cambridge Associates, 2016

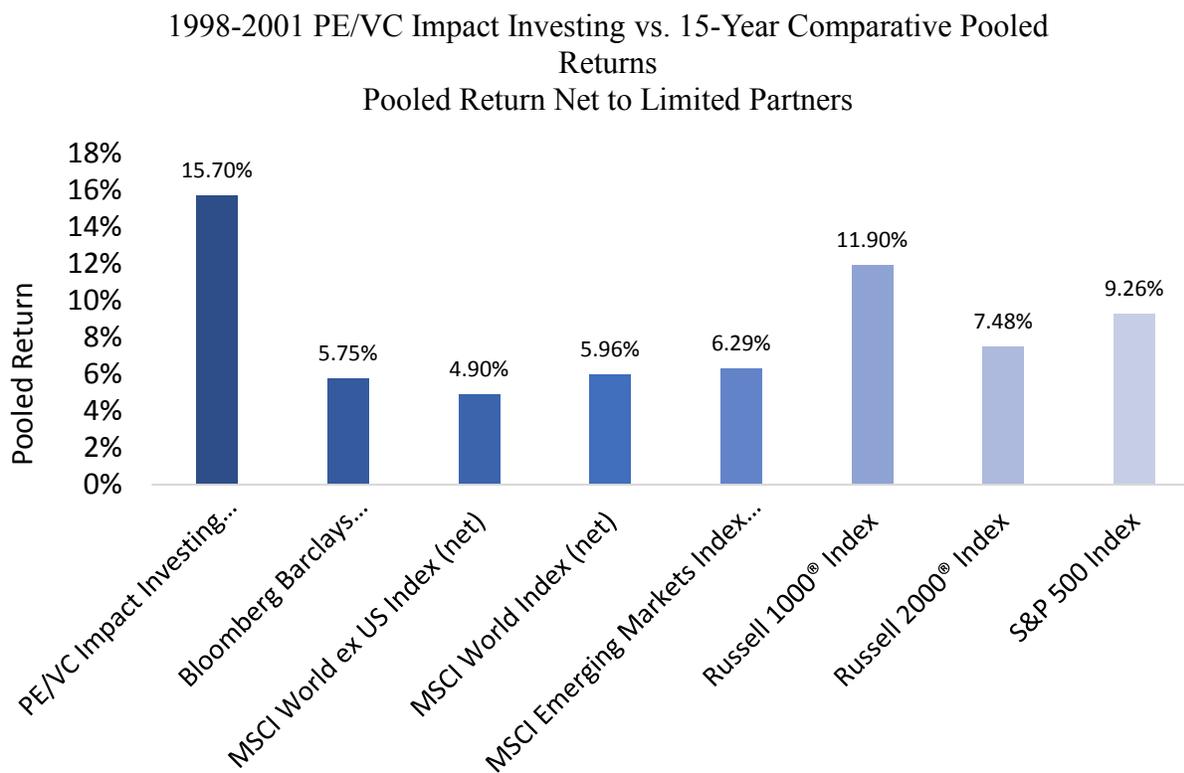
Figure 4 shows the returns for developed markets impact investing funds compared to indexes including the following:

- S&P 500 – American stock market index based on the 500 large-cap companies,
- Russell 1000 Index – a subset of the Russell 3000 Index, including 1,000 of the largest U.S. companies,
- Russell 2000 Index – a subset of the Russell 3000 Index, including 2,000 small-cap U.S. companies,

- Bloomberg Barclays Government/Credit Bond Index – includes diversified sovereign bonds.

The returns for developed markets impact investing funds have grown substantially, with the 5-year return at 12.01% compared to the 15-year return of 4.72%. Additionally, the 5-year returns of the developed markets impact investing funds have surpassed the returns of the Bloomberg Barclays Government/Credit Bond Index and have become competitive with and are approaching the returns from the three other comparative indexes.

Figure 5



Source: Cambridge Associates, 2016

Figure 5 shows the returns of PE/VC impact investing funds founded between 1998 and 2001 compared to the 15-year returns of the same five indexes already mentioned, with the addition of the following:

- MSCI World Index – measures the equity market performance of 23 developed market indexes,
- MSCI World ex U.S. Index –the MSCI World Index, excluding the United States.

PE/VC impact investing funds that were founded between 1998 and 2001 act as a worthy comparison since they have had enough time to realize the returns from their investments, compared to funds founded in 2014 that have not yet had adequate time to realize returns. The returns from PE/VC impact investing funds founded between 1998 and 2001 offer the highest

returns compared to any of the aforementioned indexes. The return for these funds is 15.70%, compared to the next highest return of 11.90%, seen by the Russell 1000 Index. Survivorship bias could be a possible reason for these high returns. Survivorship bias is “based on the notion that poor-performing funds will eventually drop out of the benchmark and cease data submissions, which, over time, biases performance upward as only the strongest performers remain in the dataset” (Cambridge Associates, 2015). However, Cambridge Associates states that there is “no reason to believe that survivorship bias will skew the Impact Investing Benchmark any differently than it would skew the comparative universe or, for that matter, any of Cambridge Associates’ other PI benchmarks.”

DISCUSSION OF RESULTS

Summary of Results

The following is a summary of the results described above:

- The number of PE/VC impact investing funds founded each year is increasing at a rapid rate, from 6 funds founded between 1998 and 2001 to 16 funds founded in 2004,
- The 5-year returns for PE/VC impact investing funds have greatly increased compared to the 15-year returns – 9.13% compared to 5.75%, respectively,
- The 5-year returns for emerging markets impact investing funds have increased compared to the 15-year returns and they have surpassed the returns of the comparative MSCI Emerging Markets Index,
- The 5-year returns for developed markets impact investing funds have substantially increased compared to the 15-year returns (12.01% compared to 4.72%, respectively) and

they have surpassed the returns of the Bloomberg Barclays Government/Credit Bond Index and are competitive with the returns of the remaining three comparative indexes,

- PE/VC impact investing funds founded between 1998 and 2001 offer the highest returns compared to the 15-year returns of any other comparative indexes.

Increasing Number of Impact Investing Funds

The number of impact investing funds is increasing at a heavy growth rate. The fact that this is occurring indicates that impact investing is becoming more appealing to fund managers and investors alike. This could be for a couple of reasons. First, impact investing is gaining more recognition. For example, TPG Capital, a large private equity firm, started its impact investing fund in 2016, called TPG Rise (The Rise Fund, 2016). In an interview, Bill McGlashan, co-founder and CEO of TPG Rise, said “It’s clear that as people talk about sustainable development goals, that the private sector has to lean into it. It’s going to take private sector capital.” McGlashan recognizes that public institutions are increasing their focus on addressing ESG factors with investments and notes that the private sector needs to get involved in impact investing as well – that it will take private sector capital to reach these goals. The Rise Fund recognizes that:

Impact investing upends a long-held tenet that financial success is antithetical to a social mission. Impact investors aim to harness the power of the market to drive sustainable social and environmental change, which means that profits are not only possible, they are necessary to fulfil the mission (TPG Rise Fund, 2016).

The fund seeks not only social impact, but competitive financial returns as well. As more firms realize that this combination of social impact and financial returns is possible, more impact investing funds will be raised with more investors being willing to allocate capital to these funds.

A second possible reason for the increase in impact investing funds is because of the recent focus firms have placed on corporate responsibility and setting ESG goals. The idea of using social and environmental factors as metrics to evaluate company performance is a relatively new concept. The “triple bottom line” is mostly recognized by large, public companies, but it is possible that investors are now expecting private companies to place a focus on ESG factors as well, thus leading to the increase in capital allocated to PE/VC impact investing funds.

Increasing Returns

The overall returns for PE/VC impact investing funds have increased in the past five years. This increase in returns reflects the improvement in management of the funds. As impact investing becomes more largely recognized, more research is done on best practices. As managers learn more about handling these funds and what successful impact investments look like, they will see higher returns from those investments. The PE/VC Impact Investing Benchmark used in this study is the first benchmark created to measure the returns for PI impact investing funds. The creation of this benchmark shows that research on impact investing reveals competitive financial returns. These findings will motivate future research on best practices in managing impact investing funds and will most likely lead to steady growth of the returns from these funds in the future.

Competitive Financial Returns

Impact investing funds in both emerging and developed markets offer competitive returns to those of the comparative indexes. Most notably, PE/VC impact investing funds founded between 1998 and 2001 offered the highest returns compared to the 15-year returns of each of the comparative indexes. This indicates that financial returns do not need to be sacrificed in order to create a social impact. Impact investing funds can offer returns that rival, and even surpass, the returns of comparative indexes.

Limitations

Limitations in the data involved in this study are apparent. First, data concerning the returns for private companies is not available to the public. The only accessible benchmark that provided data on the returns of private investment funds focused on impact investing is Cambridge Associates' PE/VC Impact Investing Benchmark, as referenced throughout this study. So, this study assumes that the data provided in this benchmark is accurate and representative.

Second, impact investing is a new concept on which limited research has been done. This contributes to the fact that there is only one accessible benchmark focused on private institutions that currently exists. Analysts must conduct future research and create additional benchmarks in order to have a more complete understanding of impact investing performance and its potential for growth.

Next Steps

Impact investing is a new, but quickly growing form of investing. According to this study, the financial returns of private equity and venture capital impact investing funds can compete with, and even surpass, the returns of comparative indexes. This conclusion, however, is based on the data provided by a single benchmark. This calls for the creation of more benchmarks in order to provide more insight to the returns offered by impact investing funds and to provide support for the results of this study and for the data provided by Cambridge Associates' PE/VC Impact Investing Benchmark.

In addition to benchmarks that measure financial performance, there is also a need for benchmarks that measure social impact. To create these benchmarks, future studies should include research focused on the metrics used to measure social impact. Social impact is more difficult to quantify than financial returns. However, having a standard metric for measuring social impact would create a way to ensure that impact investing funds are actually creating a social impact, how linked the social impact is to financial returns and which funds are creating the most social impact compared to financial returns.

The 5-year returns of PE/VC impact investing funds have risen compared to the 15-year returns. This could be due to increased fund manager experience and knowledge of the most efficient ways to deploy the capital of their fund. Further research should focus on best practices when it comes to managing impact investing funds. This will not only increase the number of managers that are interested in impact investing, but will also promote the continued growth of returns seen by impact investing funds.

Finally, research should focus on the most effective allocation of capital to impact investing funds, whether it be through university endowments, public institutions or private

funds. This capital allocation should be based on which institutions most efficiently create social impact while at the same time providing competitive financial returns.

IMPLICATIONS

Capital Allocation

Impact investing does not sacrifice financial returns for social impact. Using the characteristics mentioned earlier in this study, impact investing can be described as an asset class. First, O'Donohoe (2010) states that an asset class requires a unique set of investment/risk management skills. Impact investors must understand how to manage a fund that blends financial and social returns. In this study, we have seen that returns for PE/VC impact investing funds have grown over the past 15 years. This could be due to an increase in knowledge about what management skills are best needed for this type of fund. Second, an asset class demands organizational structures to accommodate this skillset. This is true with impact investments as the organizational structure of these funds must be catered to achieving both social and financial returns. Third, an asset class is serviced by industry organizations, associations and education. Impact investing is serviced by several types of organizations, as mentioned earlier in this study. It is serviced by educational institutions, such as the University of Chicago, by public financial institutions, such as Goldman Sachs, and by private financial institutions, such as TPG. Finally, an asset class encourages the development and adoption of standardized metrics, benchmarks and/or ratings. This benchmark creation is demonstrated in impact investing by Cambridge Associates' Impact Investing Benchmark used in this study. In addition to this, new metrics must be created for impact investing in order to measure social impact.

According to these characteristics, impact investing should be considered an asset class. Additionally, due to the number of industries and asset classes that impact investments cover, financial performance does not have to be sacrificed for social/environmental value. A portfolio containing only impact investments has the potential to be diverse enough to contest the financial performance of a traditional diversified portfolio. Therefore, larger amounts of capital geared toward ESG impact should be funneled through impact investment funds which seek to blend the two goals of ESG impact and maximum financial return.

Implications for Investors

Impact investing is a niche field that appeals to fund managers with the appropriate funds and skillset to manage these portfolios. Due to this and the fact that most impact investments are a relatively small size, this asset class is not traditionally available to retail investors. As the impact investing asset class grows in volume, investments will become larger and viable retail investment options, such as impact investment exchange traded funds (ETFs), could become available.

Impact Investments vs. Charitable Contributions

Impact investing may also provide greater efficiency toward solving social problems than traditional charitable methods. When impact investing specific funds are allocated, investors are forced to give contributions to companies and groups that they believe will have the most potential for growth and profitability, which is linked to the level of efficiency with which they solve social and environmental problems. Agents that allocate traditional charitable contributions are not forced to make risk-weighted decisions with their funds and therefore may allocate these

charitable contributions inefficiently as there are no market forces driving these decisions. The risk-weighted investment decisions that impact investors make drive the efficiency of the impact investments, creating a market for this asset class that rewards investors, businesses that are deemed worthy of growth and impact prospects and those that are impacted by these companies.

Based on this study, impact investing has potential to rival the returns of traditional, non-impact funds. It is also possible that the effect that impact investments have on solving both social and environmental problems is greater than that of traditional charitable contribution methods. If this is the case, capital allocated to charities may be reallocated to impact investments. This would impact people who give to charities, investors, charities and impact funds.

CONCLUSION

Impact investing can be defined using the term “triple bottom line.” The “triple bottom line” includes three metrics of performance: social, environmental and financial. Rather than only using financial metrics to evaluate a company’s performance, the “triple bottom line” includes social and environmental aspects as well. The same concept is true for impact investments. Impact investments seek a blended value of ESG (environmental, social and governance) impact as well as financial returns. In other words, “impact investing is the active management of one’s portfolio of capital investments to obtain a level of financial return together with the creation of social and/or environmental impact(s)” (Hebb, 2013). Impact investing differs from socially responsible investing (SRI) in that SRI seeks to minimize negative impact, while impact investing actively seeks to create a positive social impact and at the same time actively seeks financial returns.

Impact investing is a relatively new concept. The term “triple bottom line” was coined in 1994. After that, impact investing gained recognition. Today, impact investing is recognized by universities, such as the University of Chicago, public financial institutions, such as Goldman Sachs, and private financial institutions, such as TPG. This study focused on private institutions, specifically private equity (PE) and venture capital (VC) funds because these funds are a direct investment, there is more of an observable impact in private investments than public investments and PE and VC funds are risky and should provide a higher return.

The Cambridge Associates, in collaboration with the Global Impact Investing Network, created “the first comprehensive analysis of the financial performance of market rate private equity and venture capital impact investing funds” (Cambridge Associates, 2015) with their PE/VC Impact Investing Benchmark. This study used their 2016 Quarter 3 benchmark as its data source on the returns of 63 PE/VC impact investing funds. This study analyzed that data and provided the following results:

- The number of PE/VC impact investing funds founded each year is increasing,
- The 5-year returns for PE/VC impact investing funds have greatly increased compared to the 15-year returns,
- The 5-year returns for both emerging and developed markets impact investing funds have increased compared to the 15-year returns,
- PE/VC impact investing funds founded between 1998 and 2001 offer the highest returns compared to the 15-year returns of any other comparative indexes.

This study also noted that impact investments fulfill the characteristics of an asset class. So, this study concludes that impact investing is a viable asset class that offers competitive, if not superior, returns to traditional diversified portfolios and comparative indexes. More capital

should be allocated to impact investments because of their blended value of social impact and financial returns.

Future research on impact investing should focus on several aspects. First, research on impact investing should focus on best practices. Impact investing requires a unique skillset due to its seeking of financial returns and continued research on best practices when managing these types of funds is required in order to see continued growth in the financial returns of impact investments. Next, more benchmarks must be created to provide further insight into the returns of impact investments, specifically those by private equity and venture capital funds. The Cambridge Associates' benchmark is the only benchmark of its kind currently available, so there is a need for further benchmark creation. There is also a need for the development of metrics to evaluate social impact. Finally, future research should focus on the most effective methods of capital allocation for impact investments, whether it be through educational facilities, private financial institutions or public financial institutions and companies. In addition to this, there is a call for future research on the the effectiveness of impact investments in creating a social impact compared to the effectiveness of charitable contributions. Due to the blended value of competitive financial returns and social impact, impact investing will continue to grow and emerge as a viable asset class.

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