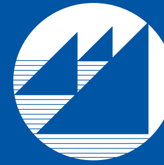
IMPACT INVESTING, RESPONSIBLE INVESTING, AND ESG INTEGRATION



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To better understand impact investing, responsible investing, and ESG integration, it is helpful to consider them as pursuing distinct objectives. These three approaches are not mutually exclusive (e.g., investing in a company with better environmental risk management strategies can align with an investor's values as well as reduce investment risk). However, due to inconsistency over the use of various terms, it is important to understand these three concepts and how they relate to an investor's goals.

Combining financial returns with positive social and environmental impacts

IMPACT INVESTING

Impact investing involves making an investment with the intention of generating a positive social or environmental impact in addition to a financial return, usually but not always a market-rate return. One of the oldest forms of impact investing is community investing, whereby deposits are made at community development financial institutions (regulated banks or credit unions with FDIC insurance). Those deposits are used by the institution to make loans in low income communities that support home ownership and the creation of new businesses, thus helping to revitalize the community. Microfinance lending is another form of community development, typically practiced in low-income countries. More recently, private equity investments are being made in start-up companies whose purpose is to create some sort of societal benefit (and if done successfully, generate profits); examples include solar-charged lanterns and water purification systems that are being sold in the developing world. Impact funds pool several such investments in order to provide easier access and greater diversification to investors.

Aligning investments with one's values

RESPONSIBLE INVESTING

Responsible investing can be thought of as aligning one's values or religious beliefs with one's investments. The most common way this is pursued is through negative screening – excluding certain companies or industries from a portfolio because of the products or services those companies provide. Common investment screens prohibit investment in tobacco companies, weapons manufacturers, or heavy polluters. These decisions are not made to drive investment performance, but rather to ensure one is not supporting (through investment) or benefiting (through dividends, etc.) from unethical or immoral activities.

Making more well-informed investment decisions

ESG INTEGRATION

Contrary to responsible investing, the incorporation of Environmental, Social, and Governance (ESG) analyses into the investment decision-making process is done in order to make better, more well-informed decisions with the aim of improving risk-adjusted returns. ESG integration begins by identifying which ESG issues are material for each company, that is, which non-financial factors are likely to have a financial impact on the company, either positively through improving competitive advantage, or negatively through poor risk management. The next step is to assess the company's performance on those ESG issues, both over time and relative to peers. Such an analysis can provide additional insights about a company's efforts to improve productivity, increase efficiency, reduce costs, and grow profits, all of which are likely to benefit shareholders.

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