Invest with Impact

The case for impact investing in public equities
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Impact Investing
Impact investing is gaining interest as a growing share of investors seeks tangible progress on environmental and social goals alongside financial returns.

We believe public equity markets have historically been overlooked in the impact investing space, traditionally a domain for fixed income and private market financing for impact projects. Yet we see public equity markets playing a growing and indispensable role in the impact ecosystem.

With a long-term, ownership mindset, impact investors in public equities create impact by providing an exit for private enterprises pursuing impact; supplying the capital needed for impact companies to grow; engaging with companies to enhance impact outcomes; increasing the visibility of undervalued impact companies, and democratizing access to impact investing.

To holistically support an impact enterprise’s enduring success, impact investing in public equities should be built on three interconnected pillars: 1) additionality through the investor’s contribution; 2) additionality through the investee (the company); and 3) additionality through the asset class.
Definition of impact investing

As a start, impact investments are investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return. The practice of impact investing is further defined by core characteristics:

**Intentionality**
Impact investing is marked by an intentional desire to contribute to measurable social or environmental benefit.

**Use of evidence and impact data in investment design**
Investments cannot be designed on hunches, and impact investing needs to use evidence and data where available to drive intelligent investment design that will be useful in contributing to social and environmental benefits.

**Manage impact performance**
Impact investing comes with a specific intention and necessitates that investments be managed towards that intention. This includes having feedback loops in place and communicating performance information to support others in the investment chain to manage towards impact.

**Contribute to the growth of the industry**
Investors with credible impact investing practices use shared industry terms, conventions, and indicators for describing their impact strategies, goals, and performance. They also share learnings where possible to enable others to learn from their experience as to what actually contributes to social and environmental benefit.

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1 The Global Impact Investment Network (GIIN) [https://thegiin.org/impact-investing/need-to-know/#what-is-impact-investing](https://thegiin.org/impact-investing/need-to-know/#what-is-impact-investing)
The case for impact investing in public equities

For a growing cohort of investors, financial returns aren’t enough. Those investors seek social and environmental progress in tandem with competitive investment performance. Impact investing through public equities provides an innovative mechanism to realize their objectives.

Impact investments are made with the intention to generate a positive, measurable social and environmental impact alongside a financial return. Its origins 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 critical role in building impact businesses across industries and geographies.
However, the structure of private investing has prohibitive characteristics, including limited scalability and limited access to such investments for most investors.

Public equities play a unique and complementary role in the impact investment ecosystem, offering solutions that private markets cannot and allowing more investors to participate in a space long available only to high-net-worth and institutional investors.

To create impact, we see the following as best practices for impact investors in public equities:

| Invest with a long-term, ownership mindset | Create a better marketplace for impact companies seeking a responsible exit from private equity | Invest capital when an impact company needs to raise more capital | Engage with companies to enhance their lasting impact | Bring much needed visibility to undervalued impact companies |

With the goal to achieve investment objectives while advancing our collective ability to address the great problems in the world, we evaluate some key points in the impact investing discussion and offer an integrated framework for impact investing in public equities.
Additionality and impact

We believe an impact investing strategy in public markets should be based on the foundational concept of “additionality.” Additionality in this context means that but for this contribution, that outcome would likely not have occurred, thereby creating impact. It’s key to the impact approach.

In microfinancing, invested capital would directly link to microloans received by an entrepreneur. If not for that capital, the entrepreneur would not have been able to build her business. Thus, the investment created impact by providing “additionality” — an outcome that would not have occurred without that capital.

Can this concept apply to public markets? In “When Can Impact Investing Create Real Impact?” Brest and Born ask whether an investor can create impact by buying a company’s stock when the purchase is from shares that already trade in the stock market. Their point of view is “Most economists agree that it is virtually impossible for a socially motivated investor to increase the beneficial outputs of a publicly traded corporation by purchasing its stock.”

Brest and Born aren’t the only ones to question whether additionality can be achieved in public stock markets. Hillebrandt and Halstead note the difficulty of providing additionality in large public stock markets, and the Impact Management Project (IMP) observes that while some public market investors seek systemic change, whereby the capital markets would eventually “price in” social and environmental impact if enough people invested for impact, this phenomenon remains speculative and highly dependent on probabilities of collective investor behavior.

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We appreciate these concerns and see two paths forward. If we were to accept the view that impact investing can only be achieved in private markets, we would also be accepting that impact investing cannot help solve the world’s great problems at scale due to the inherent limitations of private equity. Alternatively, we can innovate and encourage others to develop new solutions that address these concerns. At BlackRock, we choose the latter path and believe that additionality and impact can be achieved in public equities.

Our focus on additionality in public equities is based on three interconnected pillars:

1. additionality through the investor’s contribution;
2. additionality through the investee (the company) business model; and
3. additionality through the asset class.

Through an integrated framework of additionality, impact investors can holistically support an impact enterprise’s enduring success. As such, we see a clear path for executing impact with integrity in public equities.
Contribution from the investor

Public market impact investors can adopt five best practices to create impact:

1 Invest with a long-term, ownership mindset

From its early days, an impact company will see its shares pass from owner to owner, as private equity investors bought shares from venture capitalists who had themselves bought their shares from angel (or seed) investors, before they put their shareholding up for sale into the public markets. Once public, an impact company will have a mix of shareholder types, some very opportunistic and short term, and others that have an ownership mindset and time horizon. Impact investors, with their natural long-term horizon and inclination toward partnership with managements, can afford an impact company the benefit of focusing on its long-term goals rather than a next funding round or quarterly earnings report. Our long-term, ownership mindset is also critical in our constructive and strategic engagement efforts.

2 Create a better marketplace for responsible exits

Privately held impact enterprises are typically supported by various investors, including angel investors, early-stage venture capital, and late-stage private equity. As the enterprise grows and exits from private investment, it faces the key risk of whether it can protect its business model from drifting away from impact. In “Lasting Impact: The Need for Responsible Exits,” the Global Impact Investing Network (GIIN) highlighted a company’s exit as a critical juncture because the new investor may not share the same vision for financial growth alongside sustained impact, compromising the
very definition of impact investing.\textsuperscript{5} The GIIN’s 2019 survey revealed that 61% of respondents focused on private equity impact investing identified the lack of suitable exits as a key challenge.\textsuperscript{6} Because preserving impact is at risk, many enterprises hesitate to exit via the public market where they may or may not be able to manage this risk.

Compared with a traditional exit from private equity where investors are typically only interested in a company’s financial attractiveness, a responsible exit in impact investing means the company attracts new investors who also value two additional attributes: 1) impact and 2) a long-term partnership. The IPO market attracts a variety of participants, including short-term investors who “flip” IPOs to make quick financial gains. As impact investors, we are providing patient capital and long-term investment partnerships. In doing so, we increase the scope for more impact companies to go public and thereby unlock their full potential.

\textbf{3 Invest capital directly}

In addition to investing in IPOs, we recognize that a company’s need for capital continues throughout its business lifecycle. A company can seek to raise more capital over time by issuing additional shares of public equity and bonds. We regularly engage with companies and have seen that their need for additional capital can easily come at inopportune times, such as a period when their stock is temporarily out of favor. During such periods, raising additional capital may prove unsuccessful or come with pressure to compromise on their impact. As impact investors, our participation in a capital raise aligns with the dual objective of achieving long-term impact and financial success. In fact, a capital raise creates an additional opportunity for impact engagement. Also, capital raise transactions often take place in private institutional deals that are not available to individual investors in the broad stock market, providing additionality to the impact company.


Engage on impact outcomes

Engaging with companies on impact progress is a critical part of an impact investment strategy. Leveraging our ownership stake, our impact team constructively engages to target three key objectives: 1) advancing specific, measurable key performance indicators (KPIs) aligned with our impact thesis and theory of change; 2) creating a virtuous feedback loop, essential to monitoring how progress is achieved over time; and 3) being ready to act quickly to help a company in need, such as participating in a capital raise at a time when the company’s stock is out of favor with traditional investors, as noted above. (Examples of KPIs across different impact themes include the number of lives saved, narcotics drug relapse-free success rate, CO\(_2\) emissions avoided, cybersecurity attacks prevented, low-income women with access to financial services, and affordable housing units provided.)

We also recognize that solving major world problems is daunting. Through engagement, we seek to help our invested impact companies deliver impact outcomes through their disruptive products and services. With a focus on impact outcomes, the process is mutually beneficial: We learn a great deal from our invested companies while also sharing our own expertise. Our experience investing globally over many years has afforded us valuable insights that we can, in turn, bring to the companies with which we engage. At the same time, we are keenly aware that the solutions to seemingly similar social and environmental issues often must be tailored to the company’s regions, social norms, target demographics and policy contexts, among other considerations.

While our impact investing strategy focuses on “what” a company does through its products and services to qualify its business to have an impact, we also engage on ESG issues, which importantly focus on “how” a company conducts its operations. This includes its treatment of employees, governance practices and environmental impact. This engagement complements that of BlackRock Investment Stewardship’s broader remit across portfolios to promote corporate governance and business practices aligned with sustainable long-term financial performance by companies.
Increase much needed visibility

Impact enterprises are often overlooked and misunderstood, which we believe leads to frequent undervaluation. Only 63% of the impact companies in our investible universe are covered by sell-side analysts, compared with 86% for traditional global equities, as shown in the chart below.

Underappreciated value also can be found in a company’s intangible assets, which include intellectual property, brand power, research and development. These typically are more difficult to assess than tangible assets. As a result, with a higher proportion of intangible assets in impact companies relative to traditional firms, impact companies might not be recognized for their full financial value. In our public equities impact strategy, by discovering overlooked impact enterprises, investing in them, and measuring and reporting their impact, we are calling attention to their innovative business models and attractive investment opportunity in the investment ecosystem.
Impact companies are less covered by analysts percent (%) coverage by sell-side

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<th>BLK Impact Universe</th>
<th>Global Equities</th>
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<td>63.4%</td>
<td>85.9%</td>
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Source: BlackRock, with data from FactSet, September 2021. Chart shows analyst coverage, as defined by having more than five analysts covering a company, of global equities broadly, as represented by the MSCI ACWI Index, versus BlackRock proprietary universe of impact companies.
In terms of what qualifies as impact at the company level, we require the following.

**Contribution from the company**

A business qualifies as impact only if it meets the criteria of materiality and additionality. We typically define materiality as having greater than 50% of a company’s revenues from products and services helping to solve a major social or environmental problem, as represented by our impact themes and the United Nations Sustainable Development Goals (SDGs) and underlying targets. Our minimum requirement of more than 50% of revenues helps ensure that we are investing only in companies that place impact at the core of their business.

To meet the additionality criterion, a company’s products or services must address a need that is unlikely to be fulfilled by others (such as competitors or governments). The primary sources of company additionality are the application of leading technologies or innovative business models, as well as the delivery of a company’s products to underserved populations. By requiring additionality for impact companies, we are effectively investing in disruptive innovation helping to meet essential needs where there is strong demand but inadequate supply.

The assessment of additionality requires significant fundamental research. While there exists rudimentary tools attempting to screen for percentage of revenue that aligns with the UN SDGs, such tools have yielded inconsistent results; moreover, they cannot screen for additionality, the essential element for an enterprise to be advancing the SDGs. For instance, a prominent screening tool categorized a company that produces breakfast cereals and other packaged foods as an impact company aligned with SDG 2 – Zero Hunger. Because the company’s products could easily be replaced by competitors, and the company was selling its products primarily to populations that were not underserved, we strongly disagree with the view that it qualifies as an impact company that advances the SDGs.
Impact company example

This healthcare company is an integrated network of primary care centers exclusively focused on treating the Medicare-eligible population (U.S. citizens over the age of 65), with a particular emphasis on high-risk, chronically ill seniors predominantly in medically underserved communities.

The business model is structured on value-based care, as opposed to standard fee-for-service or volume-based care.

The company has built its model to focus on solving patient needs, and as patients become healthier, the company generates increased profits.

The company has had a strong track record of patient satisfaction and superior patient health outcomes, which we believe is due to alignment of financial incentive and effective care delivery.

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8 Company S1 filing on February 8, 2021.
Sustainable Development Goals (SDGs)

**Target 3.8**

Achieve universal health coverage, including financial risk protection, access to quality, essential healthcare services and access to safe, effective, quality and affordable essential medicines and vaccines for all.

Source: BlackRock applying UN SDGs and Targets.
Contribution at the asset class level

Quite simply, the global need for impact capital is an order of magnitude greater than what could conceivably be provided by the private markets. For developing markets alone, we face a shortfall of approximately US$2.5 trillion annually to meet the SDGs by 2030. Moreover, existing contributions from companies, governments and other organizations are not nearly enough to meet this need.

Public equities and bonds offer the potential to put capital to work toward social and environmental progress at unprecedented magnitude. To see this, note that worldwide, total assets in impact investing have been estimated at US$715 billion. In addition, non-impact private equity amounts to another US$7.3 trillion. By comparison, the market value of public equities and public bonds is exponentially higher, totaling US$105.8 trillion and US$123.5 trillion, respectively. Of course, only a fraction of private or public markets investing will shift toward impact, but it is easy to see that the deployment of only a small fraction of the public markets’ US$229 trillion into impact investing could readily create systemic change.

By implication, if we accept the view that impact investing can only be achieved in private markets, we would also be accepting that impact investing cannot help solve the world’s great problems at scale due to the inherent limitations of private equity. Moreover, with private equity being the dominant asset class for impact investing globally, impact is inherently reserved only for institutional investors and qualified, high-net-worth individuals, and typically only for those who can operate with multi-year lockups of their investments.

We have a different view. Given the magnitude of the need and the extraordinary opportunity, we must find ways for public markets to scale impact investing with integrity. By offering impact investing through public equities, a broad new cohort of investors can participate and provide much needed capital. It is long past time for the democratization of impact investing.

Complementary pathways

There is much work and exciting innovation to be done to advance the impact investing ecosystem. Together we can nurture growing seeds as well as build great forests with the complementary roles of private and public market impact investing. We strongly believe that for impact investing to help solve the great social and environmental problems, we must support impact investing as an interconnected ecosystem across asset classes, intermediaries, and end beneficiaries.
Sustainable Development Goals (SDGs)\textsuperscript{13}

Adopted in 2015, the UN SDGs are a set of 17 interconnected goals that provide a path to reducing global inequalities, protecting the planet, and paving the way towards a prosperous and more sustainable future for all. Within each goal are specific, underlying targets for a total of 169 targets.

For example, within Goal 4 for “Quality Education,” underlying targets include (4.1) ensure all boys and girls complete free, equitable, and quality primary and secondary education, and (4.4) ensure substantially increasing the number of youth and adults who have relevant skills for employment, decent jobs, and entrepreneurship.

Sustainable Development Goals (SDGs)
Learn more at blackrock.com

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