Hamilton Lane

Impact & Outcomes

Looking Beyond Financial Returns

May 25, 2021 | By Jackie Rantanen, Head of Product Management & Responsible Investment Committee Member

Anyone familiar with the private markets will know that this is an asset class with plenty of jargon: J-curve mitigation. Illiquidity premium. Capital overhang. Investing for outcomes.

We worked that last one in there, but investors who are active in the impact space may be familiar with the term. Today, as investors increasingly turn their focus to opportunities that can provide ‘returns’ beyond financial metrics alone, the concept of ‘outcomes’ has emerged. It is used to encompass both financial and non-financial results; that is, outcomes refer to the measurement of impact a given investment (or portfolio of investments) makes.

A growing number of investors are allocating capital to managers who are incorporating ESG considerations into their investment decision-making, as well as to those focused on impact investing. According to US SIF (The Forum for Sustainable and Responsible Investment), the amount of capital considering ESG factors in investment decisions has reached $16.6 trillion of managed U.S.-domiciled assets, an increase of 48% from just two years prior.[1] Here’s another interesting statistic for you: During 2019 alone, $25 billion was committed to private market impact investments.[2] And for good reason: In the ever-developing ESG landscape, we see a linkage between those GPs with a strong ESG framework and their ability to generate returns. But as notable as these numbers are, we continue to receive feedback from some investors questioning the validity of the true impact and returns being generated by these GPs.

Defining Impact

To help demystify this bit of jargon, we’ll start by offering some clarity around the term ‘impact,’ and explain how we define it in our own investing activity. Impact relates to the identifiable and measurable effect that a company has on either the environment or society. Therefore, ‘investing for impact’ takes the foundational practice of considering ESG as a risk metric a step further – focusing on proactively investing to create or enhance a company’s influence on the planet or its people. These positive impacts are meant to address some of the most pressing challenges facing humanity and the planet today, including the climate crisis, hunger, poverty, and inequity in access to education and healthcare and employment.

Investing for Outcomes: Impact Returns

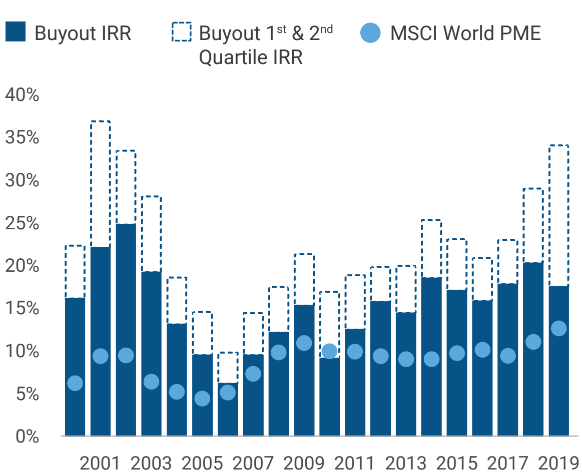
Investment into companies addressing these challenges can result in a broad spectrum of outcomes across both the environment and society, including: reduction in CO_2 emissions, reduction in waste and water usage, improved access to healthcare, housing, education, job creation, and financial empowerment. Each of these is measurable and meaningful, and identifying the metrics to measure these outcomes is a critically important element in the diligence of opportunities. Clearly, these outcomes demonstrate that the ability to align one's investing activity with one's unique objectives is more available than ever. Choices abound.

And yet, we can probably all agree that too much choice can be challenging for investors. Analyzing the opportunities requires a robust process that identifies individual metrics necessary to assess and evaluate the impact prior to investment, and that measures, tracks and reports on those metrics throughout the life of the investment. At Hamilton Lane, we look for companies with intrinsic alignment between the financial and impact mission, such that when the business does well, the impact is enhanced.

Investing for Outcomes: Financial Returns

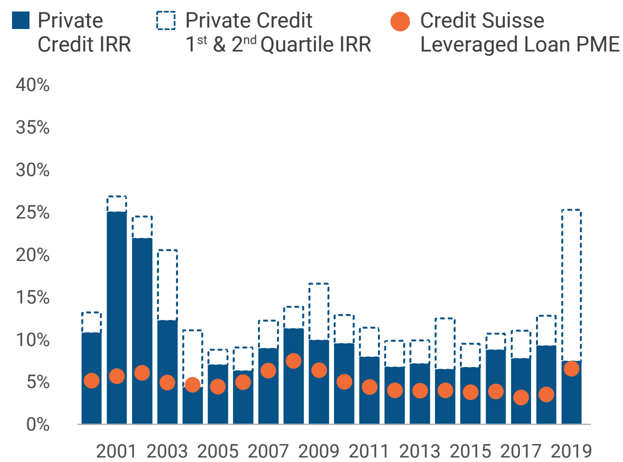
Private markets investing is particularly well suited for impact investing, given its longer time horizon and control nature, combined with a value-creation orientation. Private markets too have historically been a return enhancer for portfolios, exceeding the public markets in 19 out of the last 20 years:

Buyout IRR vs. PME



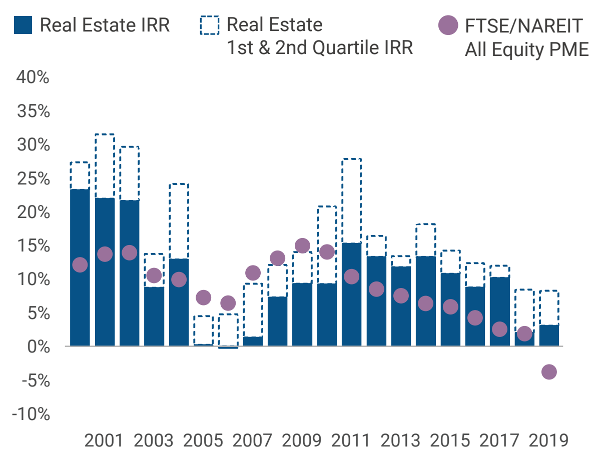
Source: Hamilton Lane Data, Bloomberg (January 2021)

Private Credit IRR vs . PME



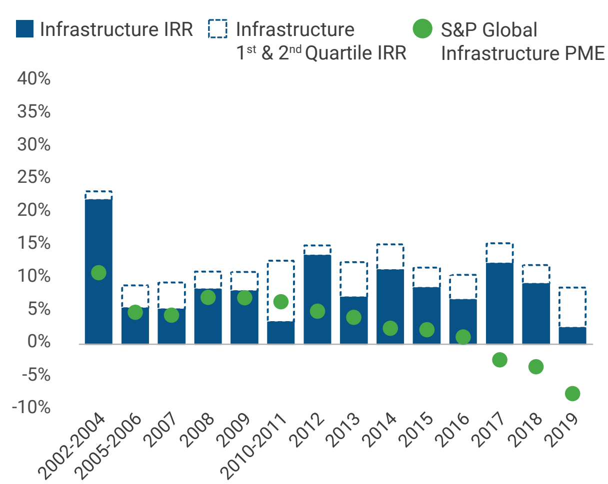
Source: Hamilton Lane Data, Bloomberg (January 2021)

Real Estate IRR vs. PME



Source: Hamilton Lane Data, Bloomberg (January 2021)

Infrastructure IRR vs . PME



Source: Hamilton Lane Data, Bloomberg (January 2021)

Investors are starting to realize that an impact strategy does not need to require any concession around returns and, in fact, in some situations this approach can be a return enhancer. As mentioned, there are myriad approaches to impact investing, but we believe that it is possible to achieve both financial and impact returns while investing in the private markets.

In fact, in our experience, many investments in the impact space are backed by strong macro tailwinds and underpinned by innovative technologies that are driving change and increasing efficiencies in connection with meaningful impact. The intersection of growth, innovation and impact makes this a particularly interesting place to invest. Investing for outcomes requires distinct analytics and underwriting to vet and understand the business and financial case for each opportunity. Strong deal flow and careful diligence is essential to successful investing in all strategies in the private markets, and investing for outcomes is no different.

Conclusion

Today's private markets investing admittedly comes with a lot of jargon (TVPI Multiple, anyone?). But if you can look past the quirky nomenclature, there are unique benefits that the asset class offers as well. We believe this to be true when it comes to the opportunity to invest for outcomes that combine financial return with positive impact. Achieving these outcomes not only requires access to robust deal flow, but also extensive analytics and underwriting to source, assess and invest in companies that are generating both compelling performance and meaningful, measurable impact. And maybe also a dictionary.

ENDNOTES

[1] US SIF Foundation, November 2020.

[2] GIIN Annual Impact Investor Survey, 2020.

STRATEGY DEFINITIONS

Corporate Finance/Buyout: Any PM fund that generally takes control position by buying a company.

Credit: This strategy focuses on providing debt capital.

Infrastructure: An investment strategy that invests in physical systems involved in the distribution of people, goods, and resources.

Real Estate: Any closed-end fund that primarily invests in non-core real estate, excluding separate accounts and joint ventures.

INDEX DEFINITIONS

Credit Suisse Leveraged Loan Index: The CS Leveraged Loan Index represents tradable, senior-secured, U.S. dollar-denominated non-investment grade loans.

FTSE/NAREIR Equity REIT Index: The FTSE/NAREIT All Equity REIT Index tracks the performance of U.S. equity REITs.

MSCI World Index: The MSCI World Index tracks large and mid-cap equity performance in developed market countries.

S&P Global Infrastructure Index: The S&P Global Infrastructure Index tracks the performance of 75 companies from around the world that represent the infrastructure industry.

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