Impact Investing 0.5

Impact investing is about purposefully making investments that achieve certain social and environmental benefits while generating financial returns. It is by construction a specific investment strategy that defines the non-financial outcomes explicitly, up front. There is, however, a more general type of impact investing which the purists will not consider impact investing but which we do. Aside from orthodox impact investing, we apply widely a concept best termed Impact 0.5.

The purpose of investing is to make a positive return. A consequence of investing is that the capital one invests is used by others. If it is used profitably, the investor can profit but if it isn't then the investor will likely make a loss. But what if how the capital is used by others is also a purpose to the investor? This is the essence of Impact 0.5.

When we invest in anything, we of course consider the potential financial returns. In addition, we consider what we are enabling with our capital. Does the user of our capital employ it purposefully? There is a reason and a place for everything. This is best illustrated by an example such as investing in banks. The most basic analysis is to determine if said bank is sufficiently profitable and stable to repay capital and dividends or coupons, and if the profitability is recognized by the market to the extent that their securities rise in value. However, banks are more than a machine for making money for investors. Banks serve a purpose. If they serve it well, they prosper and they profit their investors. What is that purpose? Banks intermediate in the allocation and distribution of credit and liquidity. When we invest, we should determine if they do this function well and profitably. If they do it poorly yet turn a profit, it is likely that the profitability is not sustainable, and they may be vulnerable to disruption from competition or regulation. Thus, a pharmaceutical company serves to address the health of its customers. A media company seeks to inform and entertain. A software company seeks to enable other enterprises. An auto company seeks to provide affordable and sustainable mobility.

Purpose focuses management, unites people and promotes collaboration. Can a business profit while acting against its purpose? Not for long and certainly not forever. As long-term investors, we do not invest in such businesses. Granted, businesses are more likely to fail from inability to adapt and innovate than for lack of purpose but innovation is best pursued when it has purpose. How do we make autos cheaper and cleaner? How do we transport more people and more material with less energy and waste? How do we cure more sickness with less stress on the public or private purse? How do we intermediate more capital with less friction? There will be businesses which impair the well-being of their customers, and some have persisted a long time. Tobacco and gaming are examples.

Impact 0.5 is transitive. When we consider a business we ask if management considers their supply ecosystem with the same lens. Every action has costs. Do they count all the costs and identify who bears them? If there are costs borne by others who may not benefit, is it acceptable? Life is seldom completely fair and we only seek to understand the extent of free riding both as parties who bear the cost or reap the benefits. We will not be able to mitigate all market imperfections but by recognizing them we can try, and at best we can avoid amplifying.

There will be successful companies that free ride, that corner markets, that appeal to our weaknesses, but the risks of disruption by market, enlightenment or regulation are high and investors who only recognize damage and not risk may find them investable. We don’t. Impact 0.5 believes that there is a natural purpose for every consumer, producer, individual or collective. If we deploy capital supporting them, we can align profit and purpose. Investing to make things better.