

# ESG ≠ Impact Investing



The popularity of environmental, social, and governance (ESG) investments has been met recently with heightened public scrutiny as investors have begun to question the legitimacy, efficacy, and measurability of ESG. Whereas ESG is often positioned in the market as a strategy for driving better outcomes for people and planet, it is, in reality, a framework for evaluating how environmental, social, and governance factors can impact a company's financial performance. The interpretation and application of ESG investing has varied across the industry in ways that have left ESG investors without clearly defined criteria around what constitutes an ESG investment or how that investment contributes to social and environmental outcomes.

How, then, should investors seek to invest in alignment with their values? At GEM, we believe that impact investing—when done well—can offer a more intentional and stakeholder-centered solution. Impact investing prioritizes outcomes on people and the planet *alongside* financial returns, and utilizes a rigorous and consistent measurement framework that provides investors with clarity and confidence around how their investments can deliver meaningful positive impact.

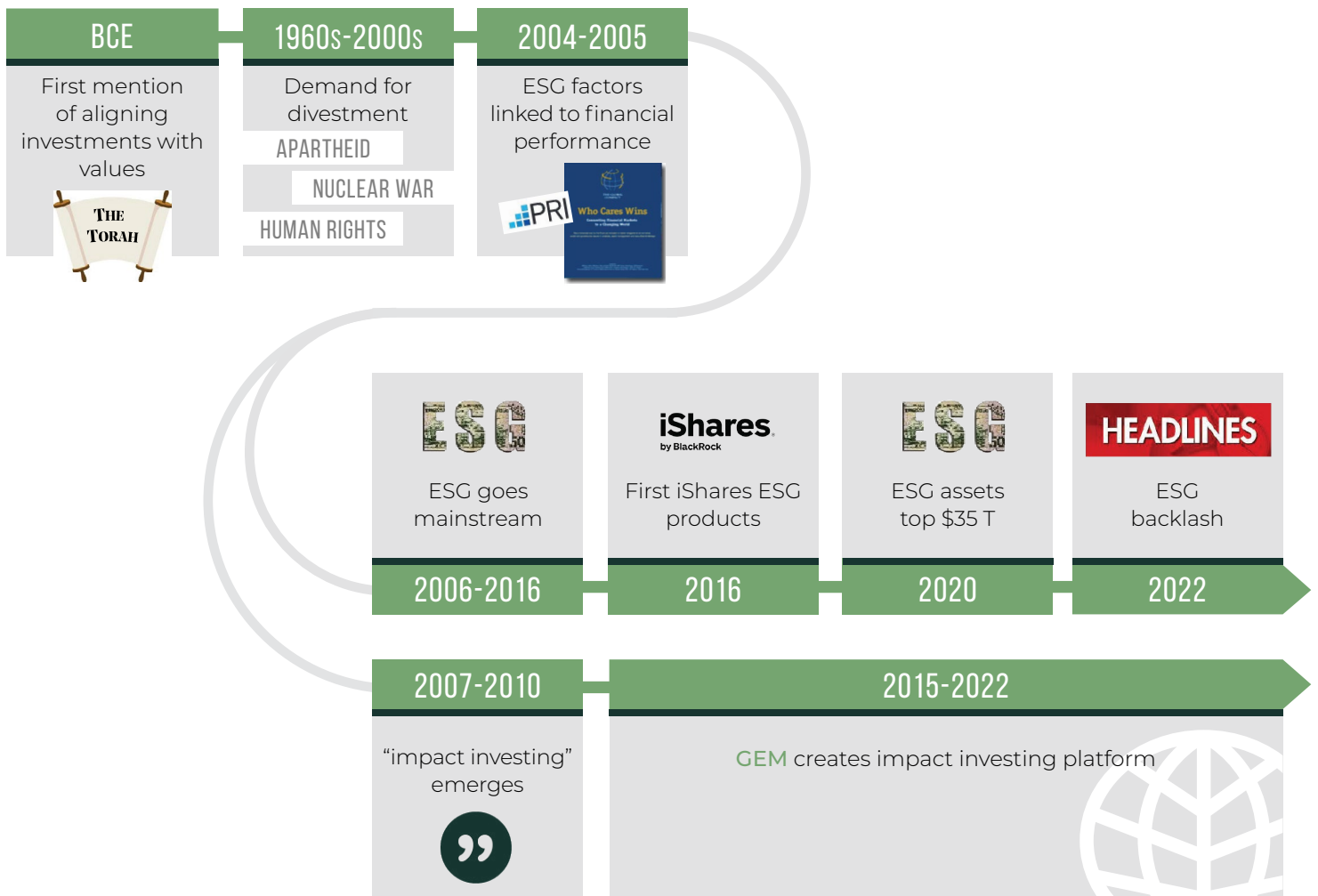
**Impact investing  
prioritizes outcomes  
on people and the planet  
alongside financial returns,  
and utilizes a rigorous and  
consistent measurement  
framework.**



# The History of ESG – A Road to Confusion

The concept of investing in alignment with values is not new—in fact, it is mentioned in some of the earliest religious texts, believed to be written as early as 1500 BC.<sup>1</sup> This approach continued, with support primarily from religious groups, into modern history and was adapted to more sophisticated investment approaches.

Starting in the 1960s, socially responsible investing gained popularity in the form of divestment movements, focused on divesting for moral and religious reasons. The narrative began to shift in 2004 with the publication of [Who Cares Wins](#), a report from 20 financial institutions stating that “Companies that perform better with regard to [environmental, social, and governance] issues *can increase shareholder value...*”<sup>2</sup> In 2005, the United Nations launched the Principles for Responsible Investment (UNPRI), through which asset managers and corporations could commit to “incorporating ESG issues into analysis and decision-making.”<sup>3</sup> This marked the beginning of a global effort to encourage investors to incorporate ESG considerations into investment decision-making, and to suggest that this practice could enhance investment returns. Between 2005 and 2021, ESG investments grew to more than \$30 trillion—invested primarily in products that selected or avoided investments based on environmental, social, and governance factors that were deemed financially material.<sup>4</sup>



It is this application of ESG—considering factors only insofar as they are financially material—that underscores the disconnect between what ESG is versus how it has been marketed to investors.

Above all, the goal of ESG investing is to underwrite investment risk and enhance financial performance. Put another way, it does not necessarily equate to better outcomes for society or the environment if those outcomes are not deemed financially material.

Moreover, the ability to reliably measure the impact of ESG products is hampered by the fact that ESG products and data are inconsistent. The correlation in ESG ratings among the largest ESG ratings agencies is less than 50%, meaning that there is no single view on which environmental, social, or governance factors (or combination of factors) have a substantive impact on financial performance.<sup>5</sup> How ESG products leverage ESG data varies considerably — from which data provider to partner with, to which factors to incorporate, to how to construct portfolios; some products avoid certain sectors altogether while others invest across sectors but select “best in class” companies. The absence of a consistent approach makes it difficult to demonstrate the long-term efficacy of ESG. (We do not disagree that incorporating environmental, social, and governance factors can lead to better long-term investment outcomes; however, we think the data measuring performance outcomes across a range of investment products can be unreliable in demonstrating the value of ESG incorporation.)

## Impact Investing = Measurable, Defined, Stakeholder-Centered Investing

**ESG**

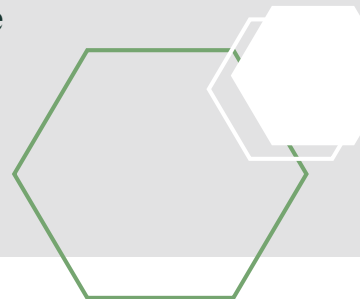
Seeks to understand how environmental, social, and governance factors affect *financial performance*

versus

**Impact Investing**

Seeks to understand how investments impact *people and the planet*

**For investors seeking values-aligned investments alongside financial returns, we believe impact investing offers a more compelling opportunity to drive positive outcomes.**



## Here's how GEM thinks about impact investing and how it can be implemented into a portfolio.

1. Impact investing is fully embedded into the firm's investment process and infrastructure, in contrast to firms where impact investing is separate, and often secondary, to the core work of the firm. Our impact team sits within GEM's investment team, where they underwrite the impact of every investment on stakeholders to drive portfolio decisions.<sup>6</sup>
2. We believe that rigor is paramount. Developed in 2019, the GEM Impact Measurement Project (IMP) Framework provides a structure through which we can proactively evaluate the impact of every investment on key stakeholders—customers, employees, supply chain workers, communities, and the planet—regardless of whether that impact is financially material or not.<sup>7</sup> In this way, our approach remains repeatable and consistent across investments and portfolios.
3. Simply put, institutional investors cannot invest for impact at the expense of financial returns. We place impact outcomes alongside investment returns and pursue both simultaneously. We believe that it is possible to seek to avoid investments that cause harm, optimize for investments that contribute to solutions, and still have a well-diversified portfolio. Moreover, we have observed that impact investments can deliver alpha by pursuing opportunities that have been overlooked or underappreciated by traditional investors.<sup>8</sup>

Unfortunately, the inconsistencies in ESG data, intention, and approach have muddied the waters for investors seeking to contribute to solutions to society's most pressing challenges. As the industry grapples with how to course-correct, impact investing continues to emerge as a clearer and more intentional approach to portfolio development that drives positive impact for people and the planet without sacrificing financial returns. We can only hope that the next phase of this movement will see values-aligned investors moving more and more in that direction.

**Impact investing continues to emerge as a clearer and more intentional approach to portfolio development that drives positive impact for people and the planet without sacrificing financial returns.**

## About GEM

GEM is a leading provider of institutional investment solutions for endowments, foundations, sovereigns, families, and other long-term investors. Since 2007, GEM has specialized in delivering the highest quality service and support to our clients, enabling them to achieve their long-term investment goals. With a global reach, broad investment capabilities, and an experienced team, GEM strategically tailors solutions to meet the unique needs of each investor we serve. For more information, visit [www.geminvestments.com](http://www.geminvestments.com).

# Endnotes

---

1. "The History of Socially Responsible Investing." Accessed November 21, 2022. <https://www.mycnote.com/blog/the-history-of-socially-responsible-investing/>
2. "Who Cares Wins 2005 Conference Report: Investing for Long-Term Value." Accessed November 21, 2022. [https://www.ifc.org/wps/wcm/connect/topics\\_ext\\_content/ifc\\_external\\_corporate\\_site/sustainability-at-ifc/publications/publications\\_report\\_whocareswins2005\\_wci\\_1319576590784](https://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/sustainability-at-ifc/publications/publications_report_whocareswins2005_wci_1319576590784)
3. "What are the Principles for Responsible Investment?" Accessed November 21, 2022. <https://www.unpri.org/about-us/what-are-the-principles-for-responsible-investment>
4. "ESG by the Numbers: Sustainable Investing Set Records in 2021." Accessed November 21, 2022. <https://www.bloomberg.com/news/articles/2022-02-03/esg-by-the-numbers-sustainable-investing-set-records-in-2021>
5. "ESG Ratings: Navigating Through the Haze." Accessed November 21, 2022. <https://blogs.cfainstitute.org/investor/2021/08/10/esg-ratings-navigating-through-the-haze/>
6. Only certain GEM funds follow an impact investment program. The firm itself and certain funds are not subject to any ESG or impact investment policy.
7. To select Impact Investments, GEM utilizes the GEM IMP Framework, a comprehensive model adapted from the Impact Management Project's Impact Management "norms" and Impact Classes, and applied by GEM to assess impact by evaluating investment strategies and managers, including but not limited to the impact of portfolio companies on key stakeholders and investment managers' contributions to impact. For more information on the Impact Management Project, please see <https://impactmanagementproject.com>. For the avoidance of doubt, GEM reserves the right to modify the GEM IMP Framework and its application.
8. Returns are not guaranteed.

# Important Notes

---

The enclosed materials are being provided by Global Endowment Management, LP ("GEM") for informational and discussion purposes only and do not constitute investment advice, or a recommendation, or an offer or solicitation, and are not the basis for any contract to purchase or sell any security, or other instrument, or for GEM to enter into or arrange any type of transaction as a consequence of any information contained herein. Any such offer or solicitation shall be made only pursuant to a confidential private placement memorandum ("Memorandum"), which will describe the risks and potential conflicts of interest related to an investment therein and which may only be provided to accredited investors and qualified purchasers as defined under the Securities Act of 1933 and the Investment Company Act of 1940.

GEM is an investment adviser registered with the U.S. Securities and Exchange Commission ("SEC"). Registration does not imply a certain level of skill or training. More information about GEM's investment advisory services can be found in its Form ADV Part 2, which is available upon request.

Unless otherwise noted, any opinions expressed herein are based on GEM's analysis, assumptions and data interpretations. We cannot guarantee the accuracy of this information, and it should not be relied upon as fact. GEM does not accept any responsibility or liability arising from the use of the presentation. No representation or warranty, express or implied, is being given or made that the information presented herein is accurate or complete, and such information is at all times subject to change without notice.

GEM reserves the right to modify its current investment strategies, exposures and techniques based on changing market dynamics or client needs.

GEM generally considers environmental, social and governance ("ESG") factors when evaluating third party managers. However, GEM may determine to allocate assets to a third-party manager notwithstanding the results of its ESG evaluation for certain portfolios, and GEM is not subject to any firm-wide policies or procedures relating to ESG. Defining and implementing ESG considerations into investment evaluation processes is an inherently subjective exercise, and it is likely that other managers or investors would define and implement ESG considerations differently than GEM.

The third-party sources of information used in this presentation are believed to be reliable. GEM has not independently verified all of the information and its accuracy cannot be guaranteed.

This presentation may include forecasts, projections, or other predictive statements based on currently available information. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. Actual performance results may differ from those presented. No guarantee is presented or implied as to the accuracy of specific forecasts, projections or predictive statements contained herein.