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Q&A

Impact investing: investing in an era of change

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In this Q&A, Helen Ford, Head of Investment Specialist Group questions Hari Balkrishna, Portfolio Manager on our approach to impact investing, and the opportunities and challenges that lie in this increasingly popular asset class.

"I believe we are entering a period when there will be a strong relationship between positive impact and outperformance of the market."

Helen Ford: Hari, what is your philosophy around impact investing and how can you make a difference as a public equities impact manager?

Hari Balkrishna: At T. Rowe Price, when we are investing in impact, we are looking for positive environmental and social impact, as well as positive financial return potential.

We start with a notion of materiality, every investment that we look at should have impact that is material to its business model. Typically, we look for the majority of revenues to come from one of our three impact pillars: climate and resource impact, social equity and quality of life, and sustainable innovation and productivity.

Secondly, we are focused on measurability. At the outset of the investment, we want to assess what key performance indicators we are going to hold our impact investments to. For instance, if we invest in renewable energy, we are considering megawatt hours of renewable energy generated by the company and the CO_2 avoided as a consequence.

The third aspect is additionality, which is especially important as a public equities asset manager. Alongside investing in companies which are creating additional impact as a direct consequence of their actions, we aim to be additional through our stewardship program, which includes company engagement and a custom proxy voting policy. We use proxy voting as a mechanism to express our impact policy and we actively engage with companies on impact issues. In our view, active engagement is a key attribute of how you can make a difference as a public equities impact manager in the ultimate delivery of impact.

The fourth aspect of our impact charter is resilience. We aim to create a strategy that embeds risk control, breadth of ideas and does not represent just the historic factor of ESG. We do this by looking forward, embracing and capturing change and making sure our impact pillars cascade multiple different sectors and geographies. With a global and future insights driven perspective, we believe we can partner with clients to target positive impact while creating an approach that seeks to embed resilience to stock specific and cyclical shocks, which are part of equity investing.

Helen Ford: What do you think about impact opportunities? There are some obvious areas such as renewables and healthcare, but what other areas excite you and are attractive from an impact perspective?

Hari Balkrishna: When we talk about resilience in our impact portfolios, it really is about looking for impact beyond the obvious. There is a range of different areas of the market that we feel embed a lot of underappreciated impact. Under our first pillar - climate and resource impact - we can clearly find impact in companies reducing greenhouse gases as part of their future business plans. Renewable energy is a well-known area, many industrials also enable other companies in their de-carbonization journey. Examples include industrial gases companies solving for our future carbon capture and green hydrogen needs. Outside of our energy transition, companies that promote healthy ecosystems and enable the circular economy we need to establish are other areas where we find meaningful and less well understood impact today.

Social equity and quality of life is our second pillar. Within this area, we are focused on companies that can enable social inclusion through financial inclusion, both in emerging and developed markets. This pillar also incorporates improving health outcomes. Here, we look for companies within the Healthcare ecosystem which improve the pace of innovation, reduce costs, or meaningfully change patient outcomes. Within improving quality of life, which is our third sub pillar within social equity and quality of life, we are focused on companies which improve physical fitness, mental fitness, and aid personal and cybersecurity.

Our final pillar, which is sustainable innovation and productivity, targets companies, which have innovated in technological solutions that solve for a social or environmental problem. This includes semiconductor companies that allow for education, technology, healthcare innovation, and digital innovation to exist, as well as companies engaged in smart city infrastructure or smart manufacturing business models. We look beyond the obvious to find positive impact opportunities across areas of the market where the future impact is yet to understood or priced correctly by investors.

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Helen Ford: While it is clear that driving impact is important, what are the challenges around impact measurement and how do you overcome those challenges?

Hari Balkrishna: To be clear, the starting point of imperfect data collection means that measuring impact is at times challenging.

The approach we take at T. Rowe Price is to take a stock-by-stock approach to the impact assessment and the impact measurement, and that happens at two levels. Before we make the investment, we use the Impact Management Project's five dimensions of impact framework. We assess; what the strategic goal of the impact is, who is getting affected by the impact, the scale, the depth, and the impact risk. Importantly, we also try and identify a key performance indicator that we can actually hold these companies to on an annual basis.

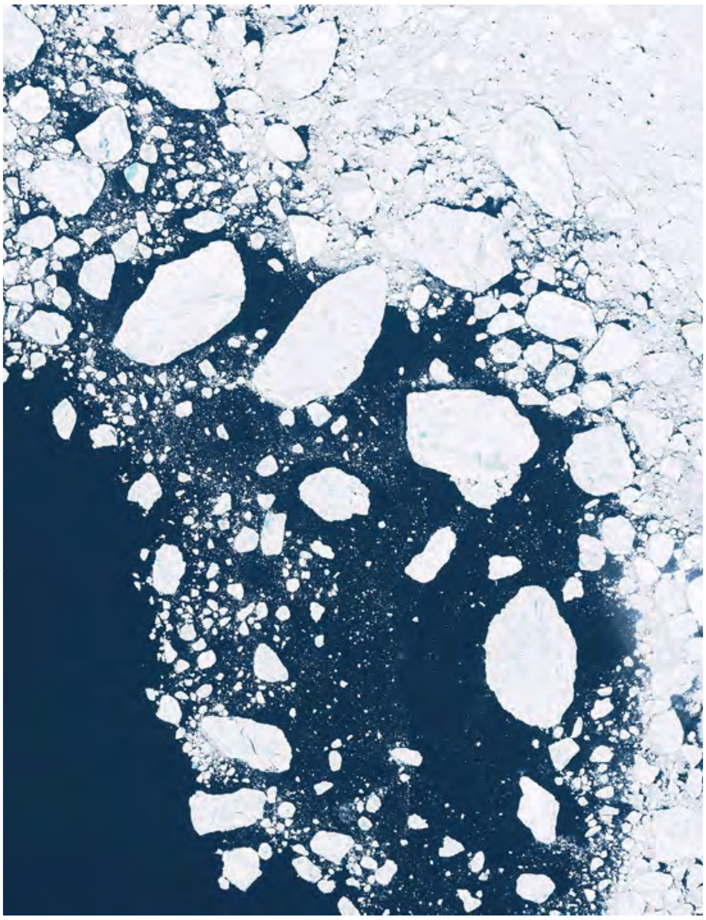
After the investment, we measure impact by using the theory of change framework. We look at inputs, activities, outcomes, and outputs, and assess the impact against the key performance indicators that we ascertained at the outset of the investment. This is important as it allows us to track the impact performance against our impact thesis. While time-consuming and complex, this analysis is backed up by data, internal research, as well as scientific and academic work where it helps to refine impact measurement.

> *"We look at inputs, activities, outcomes, and outputs, and assess the impact against the key performance indicators that we actually came up with at the outset of the investment."*

One of the easiest ways to assist impact measurement would be to improve data availability in order to develop common and widely accepted frameworks within the industry. Therefore, part of our role over time will be to engage with companies to improve data disclosure. In the meantime, we can use aggregate measures relating to emissions and carbon intensity in many industries to understand where positive impact leads to CO_2 mitigated. Environmental disclosure has improved a lot in recent years and will likely continue to improve to allow impact managers greater accuracy in their measurement.

Helen Ford: How do you go about balancing delivering impact and financial performance?

Hari Balkrishna: If you invest in companies delivering positive environmental and social impact, we believe this is typically going to focus your investment process on stocks on the change from a consumer preference, regulatory and industry growth perspective. Many of these companies will have an opportunity to capture better top line and bottom line growth prospects than the broader market. If we are able to identify these stocks at a reasonable entry point and at a reasonable valuation, our view is that this is a very solid start point with respect to potential outperformance of the market. Ultimately, my view is that over the long-term, positive impact opportunities should outperform the market.



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