THINK WORLD CLASS

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by Sanlam

Alternative assets: A rich hunting ground for impact and sustainability

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The Sanlam Investments Multi-Manager research team provides manager research capabilities to Glacier Invest as its investment partner. For more on Glacier Invest, visit glacierinvest.co.za.

Asset managers keen to maximise the impact from their investing activities are looking towards the plentiful opportunities in the alternative asset universe. However, the local asset management industry has a long way to go to catch up with the United States and other developed markets insofar as allocating assets to alternative versus traditional assets. Local pension funds' exposure to alternatives is restricted by law, while large pension funds in the United States often allocate as much as 30% of their capital to this class.

Adam Bulkin, Head: Manager Research at Sanlam Investments Multi-Manager, says it's unlikely that you will find any local institutional or pension fund with a greater than 10% allocation to alternatives in South Africa today. "But we are seeing institutional and pension fund managers migrating to private market opportunities in the debt, equity, and property segments," he explains. "In the search for differentiated sources of return, a review of the allowance for investment in alternative assets, such as private markets, should be placed on the table in South Africa."

Fund managers are carefully selected

Glacier Invest, supported by its investment partner Sanlam Investments Multi-Manager, relies on carefully selected fund managers with specialist experience in alternative investment management when seeking to build exposure to this asset class. "Once we make an active decision to increase a fund's exposure to alternatives, we want each of the underlying managers we appoint to be a specialist and focused manager, which caters for the niche they operate in," says Adam, adding that alternatives comprise a broad set of financial instruments and opportunities: from hedge funds and their different subcomponents, to private markets, which in turn include private debt, private equity, private property, and unlisted infrastructure, to name a few.

ESG: an essential consideration

Environmental, social, and governance (ESG) factors are an important aspect of all investment decisions. "We require our managers to consider the ESG risks attached to every investment we make, whether in the alternative or traditional universe," explains Adam. "This process ensures we pay an appropriate price for the risk and return on offer from each opportunity, and get an early start to engaging with investee companies to improve their management of ESG risks. However, with private markets investments, we are able not only to incorporate ESG risks into our investment decisions, but to ensure positive and impactful outcomes on the physical and social environment."

Asset managers who wish to maximise the environmental and social impact of investing will find a range of opportunities in private markets. "Before we choose a private market fund manager, we want evidence that the manager is going to invest in assets that will have a positive impact on the environment and/or society, as well as assurances that they can measure and report on those impacts," says Adam. "We do this by requiring the managers with whom we invest to report on the alignment of their investing activities with the United Nations' Sustainable Development Goals (SDGs). These SDG-aligned outcomes include new or refurbished infrastructure and job creation."

Social impact of the finance model

A consideration when choosing a private market fund manager is the potential social impact of the model used to finance the transaction. According to Adam, Sanlam Investments Multi-Manager remains wary of private equity managers that favour traditional leveraged buy-out models, where value is derived by using leverage (debt) and driving bottom-line improvement through job losses and pay cuts. For us to consider a private equity manager, the manager must intend to drive value through top-line growth, by increasing employment, and by adding long-term economic and social benefit through the goods and services they provide.

For example, the Sanlam Investors' Legacy Private Equity and Private Debt Funds have specific mandates to support businesses that suffered hardship during the 2020-21 COVID-19 pandemic. "These funds had a direct impact on businesses in terms of basic, measurable criteria like employment and jobs created," says Adam. "As a multi-manager, we require all our private market managers to submit reports on the post-acquisition improvements of underlying investment with reference to the SDGs."

Opportunities abound

The growing pressure on infrastructure in South Africa has created numerous opportunities for asset managers to make environmental and social improvements for the country and its citizens.

According to Adam, the business is hard at work identifying and investing in infrastructure equity managers, and is in the process of concluding contracts for investments into infrastructure projects in the information technology, power, recycling, and water sectors, among others. "One of the more enjoyable parts of our job is that we can see the real benefit and impact of how we allocate capital," he says.

However, in considering ESG factors broadly – in both traditional and alternative investments – Adam adds that the South African landscape requires a nuanced stance towards carbon emissions.

The South African context

“Carbon reduction is a major focus among European countries, and while it is extremely important in the South African context, there are other aspects that one has to balance against this goal,” says Adam. “For example, before closing mines, or denying them capital, we must weigh up the negative social impact in terms of employment and provision of infrastructure and energy countrywide. We need to factor in the improvements we can help to drive in public and private companies in managing ESG risks and improving their ESG credentials, rather than simply refusing to invest in companies that require improvement.”

For example, one of the unintended consequences of ongoing efforts to improve ESG scorecards has been for publicly listed companies to sell their ‘dirty’ assets to private, unlisted firms, which then continue the operations without public scrutiny. This is why asset managers must consider both the intended and unintended consequences of denying capital, or negatively screening investments, based on ESG factors.

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