Foreword by SIR RONALD COHEN

THE IMPACT INVESTOR

Lessons in Leadership and Strategy for Collaborative Capitalism

CATHY CLARK JED EMERSON BEN THORNLEY

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Contents

Tables and Figures

Tables

Figures

Foreword

When I reflect on impact investing and its prospects of growth to a size somewhere between the $100 billion of microfinance and the $3 trillion invested in private equity and venture capital worldwide, I often think back to the origins of venture capital—the starting point of my professional life.

Venture capital was a response to the needs of tech entrepreneurs, just as impact investing is a response to the needs of a new generation of social entrepreneurs who seek to make a meaningful difference in improving people's lives.

No one had thought of creating ten-year, illiquid funds, investing in small companies with very limited track records of performance, led by young people with no business experience. The response came because people sat around a table and said, "We see the future, and we have to provide the tools for it." When I set up what became Apax Partners in 1972, few in Europe knew what an entrepreneur was, and fewer still believed that entrepreneurs would achieve much of consequence for our daily lives. Forty years later, they have completely transformed our world.

The microchip, the PC, the mobile phone, and the Internet, with its search engines and instant access to information and people, have revolutionized the way we live. They have brought a transformation as momentous as that which followed the creation of the alphabet and the invention of printing. Entrepreneur-led companies have overtaken those that led their fields for nearly a century. IBM was overshadowed in the space of a couple of decades by a start-up named Apple, which is now the largest company in the world by market cap; Microsoft, Amazon, Google, and Oracle made it from start-up to being among the world's top thirty companies in just three decades.

The tech entrepreneurial revolution was driven by innovation and risk taking. It transformed the mind-set of governments about how economic growth should be achieved. In the United States, in the space of twenty-five years, it has been estimated that fifty million jobs were lost by smokestack industries, while sixty million jobs were created by new companies.

Our prospect now is to provide social entrepreneurs with the financing they require, and in this important book, Cathy Clark, Jed Emerson, and Ben Thornley provide the first detailed insight into how that financing has—and widely ought to be—provided.

However, even as the outstanding funds profiled in *The Impact Investor* work tirelessly to pioneer a new "Collaborative Capitalism," there is much work to do building market and public policy infrastructure to help a new generation of entrepreneurs replicate their success.

The Social Impact Investment Taskforce and the Role of Government

Understanding this need for infrastructure and the paths to its creation has been the charge of the Social Impact Investment Taskforce, announced by UK prime minister David Cameron in June 2013 and established by the G8. By the time this book is published, this group, which I have been privileged to chair, will have just concluded its deliberations and published its report.

The Taskforce included a private and a public sector member from seven G8 countries and the European Union (EU), and observers from Australia and development finance institutions; it held hearings in different countries and created four working groups and seven National Advisory Boards to advise on the enabling infrastructure for impact investing in various local contexts. In total, the Taskforce has engaged more than two hundred of the world's foremost experts on impact investing in responding as vigorously as possible to the social challenges we face.

The Taskforce has played a particularly valuable role, clarifying the role of government in impact investing and informing the approaches of its different member countries by sharing examples and lessons from efforts in each jurisdiction.

For the United Kingdom's part, Bridges Ventures, which is featured in this book, provides one of the earliest examples. Bridges Ventures was created as an outcome of the UK Social Investment Task Force fourteen years ago, which I was also privileged to lead, and, after securing half of the funding for its first fund from HM Treasury, has gone on to become one of the largest impact investors in the world, with more than £400 million under management in both the United Kingdom and soon in the United States—an exemplar of what this book calls "Policy Symbiosis."

Another piece of enabling infrastructure in the United Kingdom that is particularly powerful is Big Society Capital, an investment "wholesaler" with £600 million of equity capital to invest in social investment intermediaries, comprising £400 million that has sat unclaimed for fifteen years in bank and building society accounts, and an additional £200 million from the United Kingdom's four largest commercial banks.

Big Society Capital has already put the United Kingdom in the lead in terms of its market structure and number of social impact investment participants. Two dozen social impact investment intermediaries of significant size exist: Big Issue Invest, Bridges Ventures, Charity Bank, ClearlySo, Impetus-PEF, LGT-Berenberg, NESTA, Social Finance, Social Investment Business, and Unlimited, to name but a few. Virtually all of these have been backed by Big Society Capital, which is building capital flows to these and other social organizations through equity, social impact bonds (SIBs), and unsecured and secured debt. At the start of 2013, £25 million was in impact investment managers' hands in the United Kingdom; at the start of 2014, the sum was over £150 million.

From the United States we have much to learn from the experience with the Community Reinvestment Act and the New Markets Tax Credit, which together bring more than $20 billion of investment a year to poorer areas of the United States. The US federal government has also provided outcomes funding for SIBs and is actively engaged in promoting impact investment through the White House Office of Social Innovation and Civic Participation.

In France, capital flows into social organizations have benefited from allowing pension contributions to go to funds that invest 7 to 10 percent of their assets in tackling social or environmental issues.

And across the EU, the European Investment Fund is leading the effort to develop impact investment management firms running sizable funds.

Optimizing existing ecosystems to support social entrepreneurship and investment is one important role for government. A second is to be a constructive commissioner of impact investment, focusing not on the layers of cost that impact investment necessarily involves but on the cost per successful outcome. And a third focuses on international development, where $150 billion is expended every year in aid, and governments are looking for more innovative and effective approaches to tackling the challenges of economic development and the social issues that constrain it, such as literacy, child malnutrition, and illness.

Addressing Constraints on Economic Development

Social entrepreneur after social entrepreneur, investor after investor, governmental minister after minister, and countless business leaders and financiers all came before the Taskforce and argued that a revolution was needed in the way we tackle social issues. Government resources available for this fall far short of increasing social needs. This is why I think that impact investment's time has come.

But to make progress, we must clearly understand the challenges at hand, and focus considerable energy on removing remaining barriers so that the breakthrough in thinking that has enabled impact investing—namely, the measurement of social outcomes and their linking to financial returns—really does provide social entrepreneurs with the keys to the capital market.

Cathy, Jed, and Ben define and describe a practice of Collaborative Capitalism that is broad—with the power to influence all business and finance—yet driven by impact investment that is initially concentrated in private markets, just as tech venture capital was.

Impact investing is indeed both an "approach," across asset categories, and also a part of the alternative assets class, where it offers a unique form of private investment that is largely uncorrelated to public markets.

Similarly, international economic development is a core objective for many impact investors—we are all for the incidental impacts of regular commercial activities in low-income communities, such as job creation—yet economic development is insufficient in and of itself. We must also address the *constraints* on economic development internationally, through the provision of services to tackle such problems as literacy and school dropout rates, the eradication of disease, training of the unemployed, and so forth. Driving capital through development impact bonds (DIBs) toward tackling these social constraints on economic development is one example of what the impact investing movement is all about.

Again, *the lynchpin is the realization that social outcomes can be measured,* for interventions on everything from recidivism, homelessness, foster care, and educational dropout rates, to malaria, early detection of diabetes, and sleeping sickness eradication.

I believe that within five years, we will know the costs of an intervention for most social issues, the savings government can yield from an intervention, the price a philanthropic donor or a government is paying in the market for the particular outcome, and the greater value to society—the secondary and tertiary effects—of someone being rehabilitated, for example.

The Taskforce is providing guidelines for metrics and benchmarks in dealing with key issues. Conventions will be set over time just as we have accounting conventions for, say, recognition of revenues in a software company. There will be professional firms carrying out independent verification, and organizations to gather information and make useful comparisons.

In the United Kingdom, we see, in private asset classes, financial products that strike directly at important social issues. SIBs are among them, representing a particularly innovative proposition by connecting financial performance directly to social outcomes. If average returns delivered are on the order of 7 percent, as expected, and these returns are "uncorrelated," because recidivism rates, adoption rates, and other social measures do not fluctuate with the stock market, this low correlation will offer valuable diversification benefits. If these returns hold up over time, this should lead to allocations to impact investing of several percent of total assets in most portfolios.

The Contours, Challenges, and Transformative Potential of Impact Investing

The authors of this book trace the history of impact investing back to socially responsible investing and the impulse to integrate environmental, social, and governance factors in public markets. I too am enthusiastic about an increasingly impactful approach to investing in public companies and look forward to seeing investors reward strategies designed with a measureable social outcome in mind. Among the actors emerging in impact investing are larger corporations focused on specific impact projects. Group Danone, for example, has created Grameen Danone Foods, a yogurt factory in Bangladesh whose mission is to help reduce childhood malnutrition, increase children's growth, and improve their concentration in school.

I also see a role in impact investing for corporations as outcome funders and mentors for charitable service providers addressing issues relevant to a corporation's business. For example, a company selling health products might want to be one of the outcome funders alongside government and health maintenance organizations for social impact bonds that seek to reduce the number of prediabetics contracting Type 2 diabetes.

For what are becoming known as "profit-with-purpose companies," sometimes known as "for-profit social enterprises," an important challenge will be "locking in" mission through special-purpose corporate forms, such as the B Corporation in the United States. Socially driven investors want assurance that these businesses will not abandon their mission. Corporate structures that enable entrepreneurs and investors to know that the mission of the business will be locked in beyond a sale of the business are an increasing feature alongside the presence of measureable social objectives.

Impact investing may reach scale sooner by capitalizing for-profit businesses, but it is likely to be most transformative for nonprofit, charitable organizations. In the United Kingdom alone, there are 160,000 charitable organizations, including many service providers to the less well off. Most are small and have no money. In 2000, the UK Social Investment Task Force estimated that three-quarters had insufficient capital to look ahead more than three months; more recent annual surveys of the US nonprofit market by the Nonprofit Finance Fund paint the same picture.

Figures from the United States also illustrate the problem of inadequate resources. Despite three-quarters of a trillion dollars in US charitable foundations, and nine million people employed in nonprofits, very few US service providers have managed to raise the funding necessary to achieve scale. Over a period of twenty-five years, fifty thousand US businesses have successfully crossed the line of $50 million in sales. How many nonprofits have done so in the same period? Just 144.

The primary reason nonprofit organizations face this predicament is that traditional philanthropy has focused on the act of charitable giving rather than on achieving social outcomes. It has given charitable organizations money for two or three years and then, as a well-intentioned sanity check, directed them to raise money elsewhere after that—oh, and not to waste any of it on their overheads.

Yet if business entrepreneurs had come to me at Apax with business plans that involved investing nothing on overheads, I would have shown them the door. The combination of unpredictable funding and lack of investment capital has prevented almost all charitable organizations from realizing their potential effectiveness and scale.

Philanthropic foundations have a special role to play in driving innovation in nonprofit organizations, and are gradually rising to the challenge. Some foundations now seek to measure outcomes from their grant activities, by way of qualitative if not quantitative criteria. Some are beginning to see impact investment as a very focused complement to philanthropic grants. Some are using their endowments to attract investors, as the Rockefeller, Bloomberg, and Pritzker Foundations have done by taking first-loss positions ahead of third parties. Some charitable foundations are beginning to see themselves as the natural drivers of impact investment, especially the kind that carries the greatest financial risk and the potential for the highest social return. They think it natural to achieve their social objectives through some direct investment from their endowments.

■ ■ ■

All investors will find this an informative and valuable book, a must-read for anyone serious about impact investing and sustainable business more broadly. For investors interested in improving people's lives, the book lays out a refreshingly detailed overview of the area. And Cathy, Jed, and Ben's predictions in their final chapter include many powerful ideas, including a number that chime with the work of the Taskforce: integrated reporting, the globalization of financial innovation, new concepts of fiduciary duty, and the importance of corporate and stakeholder alignment.

Impact investing, more than anything, needs leadership. And this leadership does need to be cross sector, or, in the authors' terms, multilingual. We need it from investors in a position to pilot entrepreneurial ideas; from larger, commercial institutions whose participation is helpful to scaling the sector; from philanthropists and foundations, who can take risks to catalyze impacts; and from policymakers, who can help create a multisector playing field more conducive to improving lives.

In truth, there are no more excuses for *any* of us not to act. Social outcomes can be measured. Governments are open to the best ideas on how to move forward. Investors are participating as the right products become available. The rise of impact investing requires only that we coordinate our efforts and, with careful urgency, bring the "invisible heart" of markets to help those whom the "invisible hand" has left behind.

Sir Ronald Cohen
Chair
Social Impact Investment Taskforce
Established by the G8

Preface

Picture . . .

. . . making an investment recommended by the local broker managing your retirement savings and then pulling up an app on your phone that shows the affordable housing development in your community that the investment is helping finance.

. . . seeing a news article on the need for more employment opportunities offering sustainable wages, benefits, and professional training for the people of your region and then reviewing the investment report from a local fund quantifying the precise number of jobs it had supported with your capital.

. . . collaborating with your start-up team to launch the business you've been planning for the past few years—and knowing there are investors on the other side of the term sheet as interested in the social relevance and intentional impact of your venture as they are in its financial health.

Over recent years, the world has been witness to an accelerated process of economic evolution coming simultaneously from the fringe and the mainstream. It is a fusion of previously disparate areas of expertise and a vision emerging out of traditional finance, community and economic development, environmental finance, and social entrepreneurship. Following two years of in-depth research, case-studying the experience and track records of twelve of the leading impact investment funds operating in markets around the world, *The Impact Investor* offers a window through which to view this larger transformation.

The work of the twelve funds has been significant. Among other things, they

- Created and sustained more than 1.3 million jobs in underserved markets
- Provided more than seventeen million people with access to finance previously beyond their reach
- Managed portfolios of impact investment with more than 40 percent of their investments going into women-led firms and 60 percent of their funds invested in businesses operated by individuals from racial and ethnic groups historically excluded from mainstream financial markets
- Have raised and invested in excess of $1.3 billion in impact capital

The funds represent but a snapshot of larger trends under way around the world—trends we believe have the potential to transform business and finance as we know them today. Although in some ways the managers of these funds are simply taking traditional business practices and applying them to new markets, they bring a profound new investment perspective that integrates economic opportunity within a social and environmental context. This investment perspective is a new analytic mind from which all financial professionals may learn. As you will see explored in the pages to come, these investors operate with what we call a "multilingual" skillset—with the capacity to speak profit and purpose, financial return and social impact.

If you take nothing else away from *The Impact Investor,* consider this:

There is a new way of investing that is in the process of deep evolution and no longer sits on the edge of mainstream economics and capital markets.

These managers do not think in terms of "do well and then do good" or "financial-social trade-offs." Rather, they think in an integrated way that intuitively seeks to capture the full nature of value through their investment strategies, seeking financial return *with* impact. They do not see impact as the unique domain of traditional channels of the public and nonprofit sectors. These actors and the funds they bring to market extend the work of previous investment pioneers and represent a potentially powerful force integrating numerous worlds into a single, sustainable whole.

These new approaches to investing are not being forced on markets, but are drawn into them at the same time as they are emerging out of them. The world is changing as we confront the shortcomings of an “either-or” understanding of capital—either you make money or you give it away—in favor of an integrated investment practice that rejects the short-term approach to managing long-term goals, with no consideration of off-balance-sheet factors such as worker health or the availability of water or the environmental sustainability of a company’s supply chain. Some of the change under way in our world is about simple self-preservation (if you’re a beverage company operating in emerging markets and are not taking water issues into account, perhaps you will be in a different line of work five years from now!); other parts come from those intentionally seeking to use investment capital to drive positive social and environmental impacts.

This book is just the latest stepping-stone in a growing body of research across the fields of social entrepreneurship, blended value, community development finance, microfinance, workforce development, impact assessment, sustainability, corporate responsibility, and socially responsible investing. In the past five years, more has been written about the purpose, scope, and activity of these fields than ever before, with increasing speed and regularity, from more diverse and global voices.[1]

What we add to the nearly daily drumbeat of new blogs and reports is a deeper empirical look at what is being done and accomplished by funds that have established a tangible track record, in order to understand this emerging field with fresh eyes and to more confidently predict what will come next.

What this track record of research points toward is the reality that impact investing is moving from anecdote to analysis, from the whipsaw opinion of hopeful pundits to perspectives informed by sharp experience and insights grounded in practice. Our research is drawn from the concrete experiences of twelve funds precisely because that level of in-depth analysis is what is now required to move our collaborative efforts from the initial questions of “Impact Investing 1.0” to the next level of informed execution.

It is no accident that Morgan Stanley, Goldman Sachs, UBS, Deutsche Bank, RBC, Bank of America, National Australia Bank, all of the High Street banks in the United Kingdom, and dozens of other major financial institutions throughout the globe are making strong plays in the impact investing arena. Other investors should take heed:

> The train has left the station.
> The tremors are being felt.

Mainstream investors are reframing assumptions governing traditional investing just as traditional philanthropists and socially responsible investors are reconnecting with their initial motivations to effectively manage assets and make use of capital to create a changed world—at the levels of individual, community, company, and market.

The rise of impact investing takes place against a larger backdrop of innovation within mainstream capital markets and newly emerging visions of the future of business. And much of this is now being driven by shifts in "consumer" demand, whether at the neighborhood level of individuals seeking to better the possibilities before them; the customer level of those seeking to align the power of their dollars with the world they seek to create; or the consumers of investment strategies and vehicles who are demanding greater transparency, less financial leverage, and expanded understandings of potential value creation generated by their capital.

The funds profiled in this book show us, concretely, what this collaborative new world looks like—in the emerging era of Impact Investing 2.0. The work of the twelve funds stands as a testament to the fact that capital can be structured to change the economic conditions of those who remain largely outside the economic mainstream.

While a great deal has been achieved, a great deal more must be done. We do not pretend to offer "the answer" to the many debates and discussions currently taking place in regard to the ability of capital and companies to advance positive change in the world; nor do we provide a template or defined road map. What we offer in the following pages is a set of organizational data points,