Demystifying impact investing for (venture) philanthropists, grantmakers, donors, social investors and social enterprises

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What is impact investing?

Put simply, impact investing is any type of investment intended to generate positive, measurable social and environmental impact alongside financial returns.

Impact investing is an investment philosophy, not a particular type of asset class. Investments may be made directly to individual enterprises (for-profit or non-profit) or via funds (or funds-of-funds) that aggregate investments, which are often in a particular sector and/or asset class.

These investments can come in many forms that provide market or below-market rates of return.

What do impact investors do?

1. Impact investors **intentionally** contribute to positive social and environmental impact by creating **a clear investment thesis and transparent financial and impact goals.**
2. Impact investors **use evidence and impact data throughout the investment lifecycle.** This information leads decision making when identifying needs, building targets, designing investment strategies, and improving impact analytics.
3. Impact investors **manage impact performance**, leveraging the ongoing data to optimize investments, identify risks, mitigate negative consequences, and transparently disclose outcomes.
4. Impact investors **contribute to industry growth** by actively enabling more investors to effectively make impact investments. Contributing to this growth includes committing to shared conventions, approaches, and standards, while sharing non-proprietary learnings, evidence, and data.

What are the core components of impact investing?

Impact investments are made with the **intention to generate positive, measurable social and environmental impact alongside a financial return.**

- **Intention:** The investor must have the intention to achieve both financial returns and positive impact. In this way, impact investing is a prism through which the investor makes decisions.

- **Measurement:** Financial measurement is standard practice for most investments, but the impact investor must also seek to measure the impact of the investment. Measurement in some form will happen at initial selection and throughout the life of the investment, at both the portfolio and transaction level.

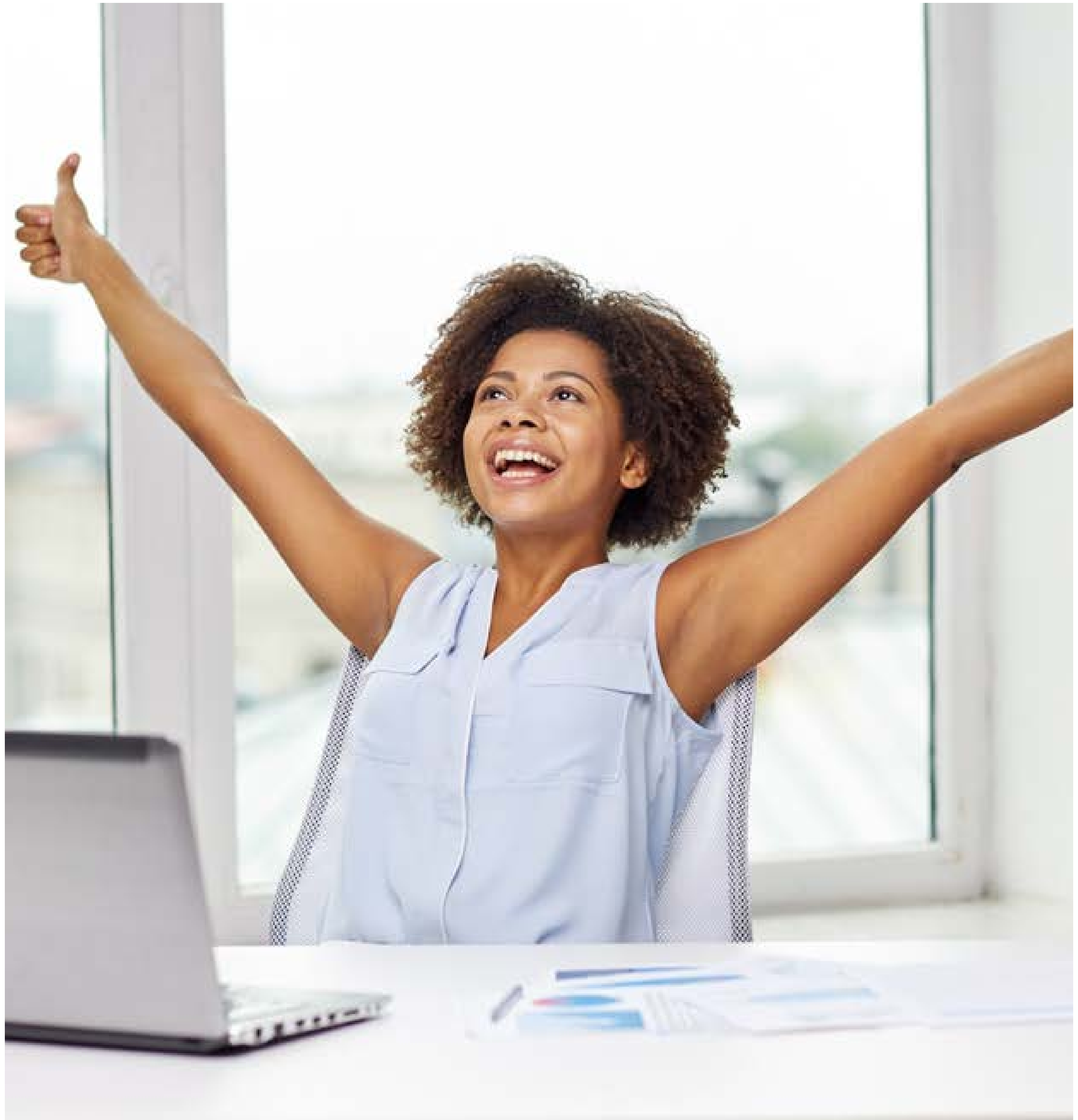
- **Contribution also known as additionality:** This variable requires an investment to meet a “but for” test: But for your investment, would the impact goals have occurred anyway or stated differently - is there an increase in the quantity or quality of the investee's outcomes and impact beyond what would otherwise have occurred.

How do impact investing work?

Impact investing works by **investing in companies that have turned environmental or social progress goals into business opportunities.**

By attracting capital and entrepreneurial talent to companies that create positive change impact investing methods can **contribute to more sustainable economic development.**

The type and development stage of companies in a portfolio can also determine the degree of the impact. For example, investors may have the most significant impact when they help fund early-stage companies to get genuinely innovative ideas materialized or by selecting companies and projects in emerging nations (where capital is scarce).



What are the benefits of impact investing?

- **You can deploy more resources to social change.** Instead of making gifts or grants that are a small percentage of your assets, you may invest some or all of your assets for social benefit. Moreover, these funds can be recycled and reused as the financial capital is returned.
- **You can expand your portfolio of tools for social good.** While philanthropy can be an effective way to pilot a program or innovation, philanthropy is not big or powerful enough to solve most social problems alone. Impact investing uses the power of the marketplace to achieve scale, and more financially sustainable solutions.
- **You can get leverage.** Philanthropic donations or concessionary capital may help an enterprise build capacity and/or de-risk the investment so that it is attractive to the enormous reservoir of market-based capital. “Blended investments” are those that are underwritten by a range of capital, including philanthropic, concessionary, and market rate.
- **You can bring integrity to your investments.** You can have the satisfaction that comes from aligning your investments with your values and social goals as well as ensuring they do not undermine them.

What are your impact investing options?

Among the possibilities, impact investing includes the following:

- Investments in socially responsible mutual funds or Exchange-Traded Funds (ETFs), often in conjunction with shareholder activism
- Investments in socially responsible fixed income products such as community and green/social bonds
- Impact-oriented private equity or venture capital funds
- Loans or equity investments in impact-oriented individual companies
- Investments in Social Impact or Development Impact Bonds
- Investments in impact-oriented real estate or other real assets such as water or timber
- Loans or guarantees to nonprofit organizations

The financial return for impact investing can be just as good as any traditional investment, or you can trade off financial return for deeper social impact. The investee can be a nonprofit or for-profit, an enterprise, or a fund. The source of capital can be your personal assets or trust, a donor-advised fund, or a foundation.

How to go about making impact investments?

- **Develop an investment policy:** The policy will typically include: a goals statement, the percentage of your portfolio dedicated to impact investing, asset allocation targets/ ranges and performance benchmarks. The goals statement will address areas such as: desired income generation, principal growth, liquidity needs, volatility and risk parameters, investing time horizon and impact goals, including "impact themes" or areas where you would like to make a difference.

- **Define your strategy** – Develop some indicators of success for your financial and social/environmental goals. Determine the primary strategies and approaches you will use, including which tools/investment products as well as how you will source and assess investments and how you will align investments with your philanthropic strategies. Develop a budget, timeline and action plan. Be sure to build in time and resources for learning, building your capacity to execute and assessment.

- **Build your capacity to execute** – Most traditional philanthropists and foundations will not have the capacity in-house to jump into impact investing. Impact investing requires not only program expertise, but ability to do credit analysis, financial and organizational due diligence, legal skills and new systems for monitoring and tracking payments. You may elect to train existing staff, hire new staff, use consultants or work with intermediaries such as banks or fund managers who can execute. Co-investing with experienced impact investors is another way to execute.

How to choose impact investment options?

Impact themes and lenses are the means through which you can sort and organize the deployment of your investment capital in alignment with your impact goals. These two categories tend to cluster around specific issue areas and impact goals. For example, the impact theme of financial inclusion may align with the impact goals of empowering women, economic equality, and community development

- **Theme:** An impact theme can be a specific industry sector, such as energy or health, or can focus on a specific issue, such as community development or social justice. Sometimes these themes may be divided into subthemes such as energy and resources or health and wellness.

- **Lens:** An impact lens is a specific view or perspective applied across all of an impact investor's assets. For example, a foundation may apply a racial-equity lens to all its investments. This means that the foundation will consider how the investments affect the underlying conditions of racial equity. Or a climate lens, creative economy or gender lens.

How to measure the impact of your investments?

Impact Management and Measurement (IMM) is the process by which impact investors can **understand the effects of their investments on people and the planet (measurement) and then take action to adapt processes and improve outcomes (management).**

IMM is an **iterative process** starting with goal setting, through data collection and impact assessment approach, to analysis and validation, and ultimately leading to better judgments and decisions for the future. This cycle of designing, collecting, assessing, and then acting should drive your impact investing strategy and implementation. Using global standards, guidelines and frameworks will help you to track and compare the progress of your investments.

You can consider for example:

- The operating principles for impact management
- The SDG Impact Standards
- The Impact Management Platform
- The OECD Guidelines

How can philanthroopy advance impact investing?

Direct capital where it is most needed

Philanthropy can pave the way for promising investments that don’t yet attract pure investment capital due to higher risk, an unproven track record, or an uncertain return timeline. In this case, philanthropy can provide risk capital, early capital, or patient capital. One example is a loan guarantee allowing a social enterprise to access credit at a favorable rate.

Share experience

For over a century, philanthropy has honed one of—if not the—most challenging aspects of impact investing: impact measurement. Philanthropy can coordinate with impact investors to appropriately evaluate impact, which can then be measured along with the desired financial return.

Build the ecosystem

Philanthropy can help develop, scale and professionalize the impact investing field through education, training, research and infrastructure building.

Want to learn more about measuring the impact of your investments, join our Impact Management and Measurement Masterclass

Need help and assistance with developing your impact strategy, impact management plans, impact measurement frameworks, impact assessments or impact reporting, reach out and connect with us

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