Antony Bugg-Levine and Jed Emerson

Impact Investing

Transforming How We Make Money while Making a Difference

An investor in Hong Kong wants to secure her children's economic future. But, she also wants to use her wealth to address the social and environmental challenges she cares about and thereby leave a broader legacy. She becomes convinced that simply giving her money away cannot be the only way she can make a difference. So, she redirects her assets into investments that preserve her wealth and also directly tackle problems of poverty and environmental degradation.

A group of friends volunteering for a nonprofit organization look for ways to help reduce poverty in rural Mexico. They stumble onto the idea of lending small amounts to poor people who cannot access loans from banks. But they struggle to secure donations and instead take on loans. When their success exhausts their available charitable capital, they convert to a for-profit enterprise and eventually hold an initial public offering on the Mexican stock market that raises more than $300 million. Suddenly they find themselves in the middle of a global media storm, lionized as saviors and vilified as greedy capitalists.

A senior investment banker in New York decides to shift career tracks to contribute to the fight against global poverty. But instead of leaving Wall

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> Street to do it, she sets up a unit in one of the world's leading finance firms to provide banking services to enterprises around the world that tackle poverty. Within a week of the announcement of the unit's creation, nearly a thousand employees of the investment bank contact her to offer to collaborate in this work.

It's easy to miss these pioneers in the crowded and complex worlds of investment and traditional philanthropy. After all, a lot has been going on in both worlds recently. And perhaps these individuals are just eccentrics we can easily ignore—a few unimportant, barely visible ripples atop the sweeping current we so often find ourselves in these days.

We believe, however, that they are important. We believe these ripples are related and are part of a shifting tide. We believe these people are among the many pioneers in the rapidly evolving global industry of impact investing. Each of them is discovering a new realm of possibility in which they are maximizing the total value of their investments and organizations, and creating a high-octane blend of economic performance and sustained environmental and social impact. Moreover, their discoveries are upending a long-held and jealously guarded belief that profit-making and charitable activities must be kept separate in isolated silos of thinking and practice.

These investors and the strategies they are executing are the early signs of a long-forming undercurrent poised to reshape how society deploys its resources and solves its problems. As Robert Kennedy famously noted, even tiny ripples, when they are multiplied and brought together, can become a powerful current that sweeps aside the established order. Powerful in its simplicity, the idea of impact investing for blended value—that is, investment strategies that generate financial returns while intentionally improving social and environmental conditions—is disrupting a world organized around the competing beliefs that for-profit investments should only produce financial returns, while people who care about social problems should donate money in an attempt to solve these problems or wait for government to step in. But one person's disruption is another's opportunity. Impact investing pioneers are jumping into these fast-flowing waters, creating new enterprises, ideas, and approaches to match the aspirations of investors and entrepreneurs eager to harness the full power of their capital.

This article describes how the ripples created by impact investing are coming together, the disruption they are causing, and the opportunities they present. The global swell of impact investing is growing, as the dynamics that precipitated the movement gather force. We cannot predict what will happen when this tide crests, but those who develop the insights and strategies to prepare for the changes it will bring will be well served.

IMPACT INVESTING FOR BLENDED VALUE: A DEFINITION

The idea behind impact investing is that investors can pursue financial returns while also intentionally addressing social and environmental challenges. Despite this simplicity, or perhaps because of it, the concept can be threatening to some people. Many mainstream investors reject the idea that they should pay attention to the social impact of their investing, insisting such considerations are the domain of governments and charities. Most traditional philanthropists and policymakers in turn reject the idea that they should use their investments to advance their mission, or that businesses generating profits have a right to stand alongside philanthropists and civil society in the noble work of promoting equality and justice.

However, impact investing is not a modern aberration. The idea that our investment decisions can impact the wider world beyond generating financial returns did not begin when we first described "blended value" in 2000, or when we convened the group that coined the phrase "impact investing" seven years later. In many ways, it reconnects with a centuries-old tradition that held the wealthy responsible for the welfare of the broader community. It is a story that goes back at least to the Quakers in 17th-century England, who sought to align their investment and purchase decisions with their values. It is also linked to Shaker congregations in Colonial America in the 1800s that launched businesses aligned with their social values to fund religious communities. Its history touches upon the environmental movement of the 1970s, the anti-apartheid divestment campaigns of the 1980s, and the more recent movements advocating fair trade consumer goods and socially responsible investments. In one form or another, aspects of impact investing have been playing themselves out on the global stage for centuries. What we see now is simply its latest iteration that links economics with the social and environmental aspects of the human experience.

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What *is* new is that impact investors are profoundly optimistic about the role business can play in advancing the common good and the leverage social enterprises can achieve by employing financial tools. We see business practices as a powerful force that can be harnessed for good, rather than a necessary evil that must be curtailed. This optimism is not ideological: we are not capitalist triumphalists eager to spread the gospel of free market greatness to the far corners of the world. We also are not ignorant of the limits of market-based strategies in effecting social change. However, we have observed what is going on in diverse corners of an increasingly connected planet, and cannot help but marvel at how many people in both rich and poor countries enjoy a better life because of successful profit-seeking investment.

We also know new challenges require new approaches. Every one of us is confronting the shared reality that regardless of who holds political office or what the latest social trend is, our social and environmental challenges are too vast and our financial resources too limited for our current approaches to work. We can no longer afford to waste capital and talent by organizing ourselves around the separate poles of financial return and social good. Blended value offers a new way to integrate our activities around the recognition that we do not seek *either* wealth *or* social justice: we seek both.

Humans are neither purely economic creatures nor purely social beings. By extension, all of our organizations have elements of financial, social, and environmental performance embedded in them, regardless of whether they are for profit or nonprofit. The sooner we recognize that and organize our public personae and institutions around this basic truth, the sooner we will be able to move beyond the bifurcated approaches to both investing and social change that have dominated our world over the centuries. These approaches have locked us into so-called solutions that have failed to consistently move our communities toward a sustainable, just, and personally powerful future.

WHAT'S IN A NAME?

The term "impact investing" came out of discussions among a group of investors and industry pioneers in 2007. They were early investors in green technology and the first institutional investors who placed equity into microfinance funds. They also had launched creative loan structures for low-income housing developers in U.S. cities and were managing public equity investments on a sustainable basis. What united all of them was an interest in assessing the potential and real performance of their capital through more than a passive financial lens. They wanted to use their capital to do something positive.

The terms in use at the time did not precisely capture these investors' interests. "Socially responsible investing" and "ethical investing" seemed burdened with moral obligation, personal judgment, and a history of screening that focused on what type of firms to avoid. "Sustainable finance" seemed narrowly focused on environmental concerns rather than on the broader array of social justice and development issues, and it also seemed to muffle the excitement these investors felt about their possibilities for meaningful investment. And although "community development finance" resonated with some Americans, it did not capture the breadth of the global investing in which these actors were engaged, did not connect with locally focused investors outside the United States, and did not reflect the premium many investors place on environmental issues or investment opportunities.

"Impact investing," however, evoked the optimism and action orientation of this group. The term provided a broad rhetorical umbrella under which a wide range of investors could huddle. The microfinance investor, the green-tech venture capitalist, the low-income housing lender: all could now see their affinity within a broader movement and begin to collaborate to address the similar challenges they faced. With its intentional double meaning, the term also cast a wide net. Some impact investors are content just to make investments that directly create a social and environmental impact. Others want their investments ultimately to have an impact on how all investment is conducted. The term has also resonated with a new set of investors who have sensed a desire to integrate their investment and philanthropy but previously lacked the language to articulate it.

WHAT IS AN IMPACT INVESTMENT?

Defining exactly what is (and what is not) an impact investment has become increasingly important as the term has taken off. And, unfortunately, many people approaching this task are still locked into old language and mindsets. They are accustomed to orienting themselves around financial return, and therefore define impact investments as below-market-rate investments that trade off financial return to make a social impact. Although these investments certainly form part of the impact-investing universe, the heart of the movement is the reorientation around blended value as the organizing principle of our work: using capital to maximize total integrated value with multiple aspects of performance.

For now the industry is coalescing around a definition that focuses on intention and on the attention investors pay to blended value returns: impact investors intend to have a positive impact as they generate financial return, and to manage and measure the blended value they create.[1]

What does this mean in practice?

All investments are capable of generating positive social impact, but some are closer to the action than others. Public equity investors can generate impact, for example, through a shareholder advocacy campaign, and investors pursuing this approach have had a meaningful impact on some corporate practices. Indeed, virtually all the impact investors we know put a portion of their portfolio in impact-oriented public equity funds. In this way, impact investing is a strategy across all asset classes. However, the shortest line we can draw between our investment choices and their social impact is to place capital directly into companies and projects, and to make loans and private equity investments as the vehicles to do so. Therefore, the impact-investing movement tends to focus on private equity and direct lending because of the unmatched power these investments have to generate social impact.

Of course, not all venture or private equity investments are impact investments, even when they seem to focus on high-potential sectors or geographic regions. Simply putting capital to work in a poor country does not qualify an investor as an impact investor. Funds and firms earning a seat at the impact investment table are focused on strategies that intentionally seek to uplift rather than to exploit poor customers, and they treat impact measurement as a central business management practice, rather than as an afterthought to use for external reporting and marketing. Furthermore, a clean energy investment that inadvertently destroys critical habitat could destroy rather than create value, and therefore does not qualify as impact investment. These distinctions matter to impact investors who are developing strategies to allocate capital where it can generate integrated, blended value.

WHAT IS BLENDED VALUE?

If impact investing is what we do, blended value is what we produce.[2] Value is what gets created when investors invest, and the recipient organizations pursue their mission. All organizations, for-profit and nonprofit alike, create value that has economic, social, and environmental components. All investors, whether market rate, charitable, or some mix of the two, generate all three forms of value. But somehow this fundamental truth has been lost to a world that sees value as being only economic (created by for-profit companies) or social (created by nonprofit organizations or government). Most business managers and investors, by failing to manage for blended value by developing an intentional strategy, miss out on the opportunity to capture their total value potential.

The concept of blended value reintegrates our understanding of value as a nondivisible combination of the three elements: economic, social, and environmental. Blended value is more than just something we can achieve by adding up its component parts because it is more than the sum of the parts of a triple-bottom-line analysis: it is its own distinct force to be understood, measured, and sought. At the same time, blended value does not mean the component ingredients of value creation lose their unique attributes and characteristics. It is not a weaving together of separate parts but a recombining of core elements that, through their natural integration, are transformed into a new, stronger, and more nuanced organizational and capital structure. Blended value is the recognition that capital, community, and commerce can create more together than the sum of the three independently, and it is less a math exercise of zero-sum pluses and minuses than a physics equation of an expanding universe of investments in organizations, people, and the planet.

The Coming Disruption

Impact investing has gained a foothold following a historic period of upheaval in the capital markets. In fact, the financial crisis of 2008 precipitated the largest impact investments of all time. Just like pioneering impact investors, governments around the world recognized the need and opportunity to go beyond making donations in their scramble to protect jobs and social stability by shoring up private companies. They invested tens of billions in loans, equity investments, and guarantees—the basic tools used by impact investors. And the forces that set off the first ripples of the impact investing movement continue to grow:

- With increasing intensity, wealthy investors and philanthropists have become impatient with old approaches in the face of intractable and increasingly visible environmental damage and poverty.

- A new generation of business and socially savvy entrepreneurs is launching ventures across an array of regions and sectors that creatively structure investment capital to tackle society's challenges and pursue new market opportunities.
- Cash-strapped governments are redefining their relationships with private business as demographic realities force a reexamination of fundamental components of the social contract.
- The rise of online social networking platforms enables thousands of investors to talk, share, and engage with each other as they identify, vet, and invest in social entrepreneurs the world over.

These forces are finding their outlet in impact investing for blended value. Implementing this simple concept is not easy. Although impact investors see the opportunities in an integrated approach, our systems have not yet caught up, and frustration abounds as the old only grudgingly gives way to the new.

The current of impact investing is stirring the waters of a bifurcated world still organized to separate profit-making from social and environmental problem-solving. For now, this bifurcated world channels the energy of impact investors into the hidden pools and underground rivers on the margins of mainstream investment and philanthropic activity. But, like water, impact investing has a powerful ability to reshape the world it flows through. The gathering force of impact investment activity is wearing away the bedrock of seemingly immovable institutions and investment practices.

Impact investors will not long be content to force-fit their aspirations into a set of systems created to support the bifurcated vision. Therefore, these systems will inevitably change under the collective weight of a new generation of investors, entrepreneurs, and government officials coming together in the pursuit of blended value:

- In the bifurcated world, established for-profit and nonprofit business models facilitate separate profit-maximizing investments and philanthropic contributions. In the world of blended value, a new class of social enterprises will organize to maximize the full blended value of investment.
- In the bifurcated world, laws and regulations clearly define and protect traditional entrepreneurs, investors, and philanthropists. They are ill suited to understand, yet alone guide, enterprises and investors seeking to maximize blended value. In the world of blended value, governments will determine how to harness impact investment to complement public resources in capitalizing solutions to society's most pressing challenges.
- In the bifurcated world, we know how to measure the value of financial investments and are getting better at describing the social impact of charity. In the world of blended value, we will create a common language and measurement systems will ensure that we steer our capital and attention to the enterprises most adept at creating profit along with social value.
- In the bifurcated world, clear pathways exist for talented people to cultivate the necessary skills and navigate separate careers in charity or business. In the

world of blended value, we will need new approaches to find and develop the professionals who want to apply their business savvy to simultaneously create wealth and tackle social and environmental challenges.

- In the bifurcated world, a vast array of institutions constitutes the capital markets that separately facilitate exchanges between the donor and the charity and the investor and the business. In the world of blended value, these capital markets will turn to the task of connecting impact investors and social entrepreneurs.

We do not want to overstate the changes that are occurring or the challenges that arise from being able to sustain innovations that lead to blended value. The bifurcated world will certainly linger, as separating investing and charity will continue to make sense to many people. However, some established systems will inevitably adapt, while others will become increasingly isolated as they fail to evolve in response to the new conditions and are replaced by new systems that do.

DEVASTATION OR RENEWAL?

Waves can create devastation when they wash ashore with uncontrolled force, but they also can be a force for renewal. Having emerged from the sustainable investing and divestment campaigns of the 1970s and 1980s, the wave of socially responsible investing has altered how executives in many industries engage with customers, regulators, and society. Impact investing in turn has emerged from the conditions that wave created, and it has the potential to be even more disruptive.

What will result from this growing wave of impact investing? Will it undermine support for philanthropy and draw resources away from more productive investment? Will it be the force that brings about renewal and provides the energy that enables us to tackle the seemingly impossible challenges we face? Or will it just fade away, as so many other waves have in the past, without making much of a difference at all?

The answer will come from how we prepare to harness its power. We will need to see the ripples for the mighty current they can become. Actors on both sides of the checkbook—those investing and those receiving investments—need to recognize that we are all part of something potentially more powerful than we can be alone. This is easy to affirm but difficult to put into practice. Many individuals are only beginning to understand the full extent of the shared approaches and values that unite them with others in this newly emerging capital market. We will be called on to take a leap of faith and believe that supporting this new industry will serve us and the rest of the world more effectively than preserving our small niches.

We must also collectively resist the danger that impact investing will become a mere marketing tool. The term's very resonance is its greatest threat. Tempted by the good intentions of clients, institutional asset managers may co-opt the spirit of impact investing by structuring investment products that appear to create value but avoid the hard work required to generate more than just nice stories with pictures.

And just like a flowing river, the current of impact investing will create opportunities that we must be organized to capture. New laws, new systems for measuring value, new capital market innovators, new approaches to cultivating leadership—these will be the drivers that convert this current into a powerful force. To build them will require all of us to abandon our assumptions and our self-righteousness and to collaborate with people and institutions we may have comfortably ignored in the past.

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Ultimately, impact investing for blended value offers an integrated system of thinking and practice that is springing forth in a world where a different system currently dominates. When systems clash, opportunities and frustrations abound. But once we realize that impact investing is a systems-building task, we can draw from the lessons of history about what it has taken to effect similar change in the past. These lessons tell us that great change is possible when people not used to working together collaborate to combine existing ideas into new possibilities. They teach us that we cannot change a system with persuasive analysis alone and must apply the full range of our emotional and spiritual intelligence. These lessons remind us to recognize the power systems have to shape us all—as well as the power each of us has to participate in changing them.

Building this new system will not be a linear process. We will define strategies and move toward goals, but we will also experience ebbs and flows, forward movement and lateral drifts. We will get there, but it will take time, focus, and commitment. And impact investing will always involve the precarious ride at the apex of profit and purpose.

Impact investing is not about bumper-sticker solutions to feeding the billions or saving the planet, and you are not passive observers of this new system. By choosing to jump in or stand back, you influence the system in which we all live. The question is not, "How can I influence the system?" The question is, "What direction will my influence take?" We all have a role to play:

- If you are a pioneer deeply engaged in this new system, build your enterprise with focus and verve, but embrace a competitive framework that is also collaborative.
- If you are an asset owner or manager, challenge your advisors and fund managers to create and bring to market investment products and platforms that offer integrated returns.
- If you manage capital or advise its owners, take responsibility for leading your principals and portfolio companies to pursue blended value.
- If you have influence over policy and regulation, clear the space that will allow social entrepreneurs and their investors to come out from where they are hiding.
- If you take responsibility for educating the next generation of leaders, honor their interest in learning how to create blended value.
- If you are starting out in your career, resist the temptation to follow the well-trodden paths that you know in your heart do not lead where you truly want to go.

We do not assume you will necessarily quit your job and jump head first into impact investing. But understanding how the current of impact investing is poised to change the world is relevant even if you stay on the shore.

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1. This definition draws on the definition in O'Donohoe et al., "Impact Investments: A New Asset Class," New York: JPMorgan/Rockefeller Foundation, 2010.
2. A wide set of papers addressing various aspects of the Blended Value Proposition and published since 2000 are available at www.blendedvalue.org.