a snapshot

CREATED BY MONITOR INSTITUTE

INVESTING FOR Social & Environmental IMPACT

A DESIGN FOR Catalyzing AN EMERGING INDUSTRY

For a copy of the executive summary or the complete report, please see www.monitorinstitute.com/impactinvesting or www.globalimpactinvestingnetwork.org

AN INDUSTRY EMERGES

OPPORTUNITIES

Growing interest among capital providers, with a growing set of ultra-wealthy investors seeking diversification and a different approach. Interest is also being spurred by the pull of growing emerging economies and more values-driven consumer behavior, as well as the push of current and expected regulatory incentives and mandates.

Greater recognition of the need for effective solutions to social and environmental challenges, with increasingly urgent threats and growing inequities.

A steadily developing track record with early successes in community development, microfinance, and clean tech attracting positive and extensive popular press and broader interest.

A flock of talent interested in careers in this space, creating a next generation of leaders.

What kind of future will investing for impact have?

Will the promise of this moment be realized, making this new domain a major complementary force for providing the capital, talent and creativity needed to address pressing social and environmental challenges?

Or will it remain a small, disorganized, underleveraged niche for years or even decades to come?

CHALLENGES

Lack of efficient intermediation, with high search and transaction costs caused by fragmented demand and supply, complex deals, and a lack of understanding of risk. The compensation system for traditional intermediaries also impedes getting small deals done which may have less lucrative fees.

Lack of enabling infrastructure to help people identify and function as part of an industry since the market is structured around a history of bifurcation between philanthropy (for impact) and investment (for returns). Networks are underdeveloped, and a lack of reliable social metrics makes the suspected trade-off between financial and social returns even harder to assess.

Lack of sufficient absorptive capacity for capital, with an imminent lack of impact investing opportunities into which large amounts of capital can be placed at investors' required rates of return.

A CRITICAL TRANSITION POINT FOR IMPACT INVESTING

This emerging industry has reached a transitional moment in its evolution.

Impact investing is poised to exit its initial phase of uncoordinated innovation and build the marketplace required for broad impact. How this transition is traversed—and how quickly—will determine the size and ultimate impact this new domain of investing can and will have.

The question for today is whether the bar will be set high enough—whether pioneering leaders will provide the talent, discipline and resources that will be needed to create a coherent marketplace with high standards for impact.

Impact Investing:

Actively placing capital in businesses and funds that generate social and/or environmental good and at least return nominal principal to the investor

Phases of Industry Evolution

UNCOORDINATED INNOVATION

Disparate entrepreneurial activities spring up in response to market need or policy incentives

Disruptive innovators may pursue new business models in seemingly mature industries

Characterized by lack of competition except at top end of market

Today

MARKETPLACE BUILDING

Centers of activity begin to develop

Infrastructure is built that reduces transaction costs and supports a higher volume of activity

5-10 years?

CAPTURING THE VALUE OF THE MARKETPLACE

Growth occurs as mainstream players enter a functioning market

Entities are able to leverage the fixed costs of their previous investments in infrastructure across higher volumes of activity

Organizations may become more specialized

MATURITY

Activities reach a relatively steady state and growth rates slow

Some consolidation may occur

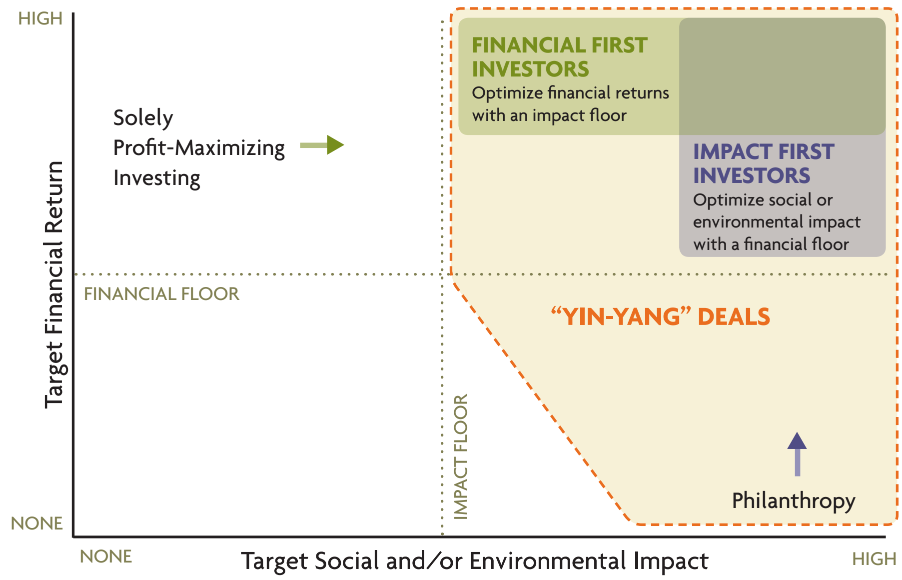
THE FUTURE OF IMPACT INVESTING

Over time any combination of these segments of investors could lead to the fulfillment of the promise of impact investing.

Impact first investors, who seek to optimize social or environmental impact with a floor for financial returns. These investors primarily aim to generate social or environmental good, and are often willing to give up some financial return if they have to. Impact first investors are typically experimenting with diversifying their social change approach, seeking to harness market mechanisms to create impact.

Financial first investors, who seek to optimize financial returns with a floor for social or environmental impact. They are typically commercial investors who seek out subsectors that offer market-rate returns while achieving some social or environmental good. They may do this by integrating social and environmental value drivers into investment decisions, by looking for outsized returns in a way that leads them to create some social value (e.g., clean technology), or in response to regulations or tax policy (e.g., the Green Funds Scheme in the Netherlands or affordable housing in the U.S.).

Segments of Impact Investors



Sometimes impact first and financial first investors work together in what we call "yin-yang" deals—that is, deals that combine capital from impact first and financial first investors and sometimes add in philanthropy as well. This name is derived from the term in Chinese philosophy describing two elements that are different and yet complementary when put together. Yin-yang deal structures can enable deals that could not happen without the blending of types of capital with different requirements and motivations.

AN APPROACH FOR ACCELERATING PROGRESS

Concrete action will be required to build the marketplace that can address today's challenges and tomorrow's risks.

Investors, **entrepreneurs**, and **funders** all have an important part to play in providing the **leadership**, **capital**, and **collaboration** needed to deliver on the promise of impact investing.

Increasing the scale and impact of this type of investing will require action to:

- Unlock Latent Supply of Capital by Building Efficient **Intermediation**
- Build Enabling **Infrastructure** for the Industry
- Develop the **Absorptive Capacity** for Investment Capital

FIVE PRIORITY INITIATIVES

Of the many important initiatives that are possible, we want to highlight the five that we believe together have the greatest potential to have catalytic impact on the industry's development:

Create industry-defining funds that can serve as beacons for how to address specific social or environmental issues. These large funds would uncover and aggregate outstanding investment opportunities that can serve as powerful examples of how major social or environmental issues can be addressed. They can attract a wave of additional investors and ideas, much as the Apple initial public offering catalyzed the venture capital industry.

Place substantial, risk-taking capital in catalytic finance structures. Funding creative models at sufficient scale is likely to require some yin-yang deals that combine impact first and financial first capital. Without some catalytic, risk-taking funding from impact first investors, the deals may not provide sufficiently attractive returns for commercial investors; and without commercial investors, it may be more challenging to invest the volume of funds required to make a difference. Unfortunately, these unusual structures are likely to meet increased skepticism from investors because of the complicated structures that have contributed to the financial crisis. But someone needs to go first. Impact first investors are most likely to act if it will ultimately produce substantial social or environmental benefits.

Set industry standards for social measurement. Developing metrics will be an essential way to draw attention to the results of an effective model developed by a fund or funds. Proof of impact is going to get a lot of people excited about investing for impact—because it will demonstrate that better, larger, different, more sustainable social impact is achievable. Developing comparative metrics will be challenging and has long been one of the toughest nuts to crack in the social sector.

Lobby for specific policy/regulatory change. Policy change has been a common ingredient in the evolution of many other industries including venture capital and private equity, and will be an important way to create incentives to draw an even broader range of investors to engage in investing for impact. Substantive change often begins in a crisis, and the financial crisis may create just such an historic opportunity. Sweeping legislation is coming in the form of fiscal stimulus and financial oversight. It can be done well or poorly, in ways that encourage investing for impact, or discourage it.

Develop an impact investing network. For these initiatives to come to fruition, the creation of a network for the industry will be essential to developing the relationships, tools, infrastructure and advocacy required.

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