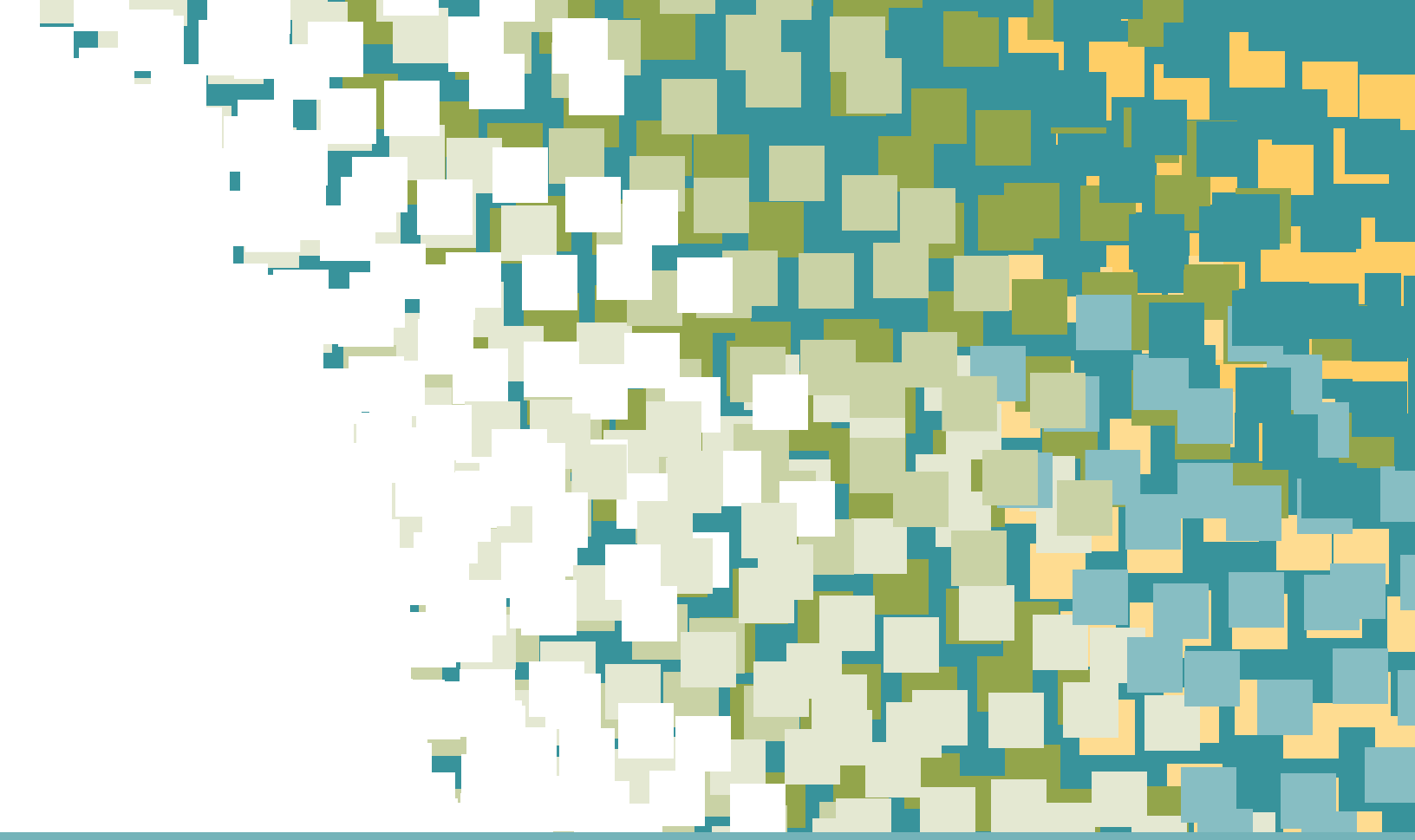

INVESTING FOR Social & Environmental IMPACT

A DESIGN FOR Catalyzing AN EMERGING INDUSTRY

created by
Monitor Institute

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ABOUT MONITOR INSTITUTE

Monitor Institute is a social enterprise that is part consulting firm, part think tank, and part incubator of new approaches. Our mission is helping innovative leaders develop and achieve sustainable solutions to significant social and environmental problems. We believe that achieving these solutions requires bold leaders to integrate pioneering ideas, effective action, and efficient capital. And we believe that today's complex challenges call for leadership from all three sectors—business, government, and nonprofit.

The Institute was founded by and is fully integrated in the operations of Monitor Group. A global advisory and capital services firm, Monitor works with the world's leading corporations, governments, and nonprofits to drive growth in the areas that are most important to them. The Institute leverages and coordinates the Group's diverse resources in 22 offices around the world to fulfill our mission. For more information, see www.monitorinstitute.com and www.monitor.com.

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WHAT IS IMPACT INVESTING?

In New York City, a low-income mother is moving into an apartment on land developed with a loan from the New York City Acquisition Fund. The Fund, created in 2004, aims to facilitate the construction of 10,000 units of affordable housing in a city with rapidly diminishing affordable housing stock. The Fund came together when private foundations made $32 million in low-interest, subordinated loans and a city-based charitable trust invested $8 million on similar terms, enabling commercial banks to raise and place more than $160 million of commercially priced debt into the fund.

In rural Tanzania, a student is reading at home by the light of an electric light bulb powered by a solar panel her mother bought on credit from a local distributor. The distribution business could reach her village because of an equity and working capital investment made by E+Co, a nonprofit mezzanine fund focused on making debt and equity investments in businesses that develop and sell modern energy services.

In Cambodia, a small business is expanding with debt from a microfinance bank. The bank is originating new loans after accessing commercial capital markets through a $110 million loan fund structured in 2007 by Blue Orchard, a Swiss microfinance-focused asset management company, and Morgan Stanley. The loan fund, rated by Standard & Poor's, was syndicated on commercial terms among institutional investors, such as pension funds, in Europe and the United Kingdom.

The New Yorker moving into her first home, the student in Tanzania studying under electric light, the small-business owner in Cambodia expanding her payroll—**none of these people would recognize one another as co-participants in the same emerging industry**. Neither, perhaps, would the commercial banker placing debt in the Acquisition Fund, the high-net-worth individuals investing in E+Co, or the German worker whose pension fund invested in microfinance through Blue Orchard.

Yet **these are all examples of the proliferation of activity occurring as a new industry of impact investing emerges**. This industry which involves making investments that generate social and environmental value as well as financial return, has the potential to complement philanthropy and government intervention as a potent force for addressing global challenges at scale. **This document is intended to shed light on the industry's recent emergence and highlight the challenges it faces in achieving its promise.**

Using profit-seeking investment to generate social and environmental good is moving from a periphery of activist investors to the core of mainstream financial institutions.

SUMMARY: PROMISE, PERIL, AND PRECISION

There are moments in history when the needs of an age prompt lasting, positive innovation in finance—from ideas as big as the invention of money, to the creation of new institutions such as banks and insurance firms, to the development of new products and services such as mortgages, pensions, and mutual funds.

Evidence suggests that many thousands of people and institutions around the globe believe our era needs a new type of investing. They are already experimenting with it, and many of them continue even in the midst of a financial and credit crisis. That's why the idea of **using profit-seeking investment to generate social and environmental good is moving from a periphery of activist investors to the core of mainstream financial institutions.**

No one can know for sure how much money has been invested or is seeking investment that generates both social and environmental value as well as financial return. But a good guess is that the total size of the market could be as big as $500 billion within the next decade.[1]

These impact investors want to move beyond "socially responsible investment," which focuses primarily on avoiding investments in "harmful" companies or encouraging improved corporate practices related to the environment, social performance, or governance. Instead, **they *actively* seek to place capital in businesses and funds that can provide solutions at a scale that purely philanthropic interventions usually cannot reach**. This capital may be in a range of forms including equity, debt, working capital lines of credit, and loan guarantees. Examples in recent decades include many microfinance, community development finance, and clean technology investments.

What's most interesting today, though, isn't identifying this new promise. **Rather, we will argue that this moment is a messy transition—made even messier by 2008's financial crisis—in an evolution of activity that is already several decades old.** How this transition is traversed, and how quickly, will determine the scale and ultimate impact that this new domain of investing can and will have.

The pressing question is whether impact investing will remain a small, disorganized, underleveraged niche for years or even decades to come—or whether leaders will come together to fulfill the industry's clear promise, making this new domain a major complementary force for providing the capital, talent, and creativity needed to address pressing social and environmental challenges.

The pressing question is whether impact investing will remain a small, disorganized, underleveraged niche for years or even decades to come.

Two types of peril will need to be confronted explicitly to seize the promise inherent in the current transition for impact investing: the risk that investing for impact will ultimately be too hard and the risk that investing for impact will ultimately be too easy.

Our premise is that there is only one acceptable answer. It matters a great deal that more of our era's assets are used to address some of its most troubling challenges.

Prompted by this question and this premise, in the spring of 2008 we began to explore what the future of this style of impact investing might be. We spent the rest of the year—in close partnership with the Rockefeller Foundation, and supported with additional funding from the Annie E. Casey Foundation, the JPMorgan Chase Foundation, and the W.K. Kellogg Foundation—engaging in the interviews, research, and dialogues that have resulted in this report. It's been a fascinating time, not least because of the backdrop of the global financial market crisis that unfolded over the course of the project.

The point of view expressed here was formed after extensive scouring of existing studies and research as well as a convening of 45 investors and intermediaries interested or engaged in investing for impact. It reflects more than 50 original interviews conducted with a range of investors—including private individuals, family offices, investment banks, institutional investors, foundations, and pension funds—about their experience with investing for impact, how they think it may evolve, and what will best accelerate its evolution. While no one can predict with certainty how the global economic markets will evolve, we have sought through these dialogues to understand the potential implications of 2008's financial crisis on impact investing.

Our analysis shows that **two types of peril** will need to be confronted explicitly to seize the promise inherent in the current transition for impact investing:

- The risk that investing for impact will ultimately be **too hard**. Here, hype, poor thinking, and sloppy execution would cause so much disappointment that relatively little capital would wind up in this new style of investing. The will to overcome the typical challenges facing a messy, new industry could disappear as investors simply give up too soon, especially in the face of strong macroeconomic head winds.
- The risk that investing for impact will ultimately be **too easy**. Here, the definition of social and environmental impact could turn out to be so loose and diluted as to be virtually meaningless. At best, this outcome would turn this type of investing into a "feel good" rather than a "do good" exercise. At worst, it could actually divert capital away from philanthropy, decreasing the resources dedicated to confronting serious societal challenges.

Successfully confronting these risks will require leaders and investors to insist on precision—on sustained rigor and reflection—in the midst of genuine excitement and good intentions. Such scrutiny would be necessary even without global financial fragility. But the travails triggered by the sub-prime credit crisis are a reminder that investing well is hard in any circumstances and wishful thinking is not a strategy for confronting real risks.

We will argue here that the precision most needed in the years ahead requires confronting a paradox: **impact investing is both one thing, and many things**. This

IMPACT INVESTING IN ACTION

Opportunities to invest for impact exist across a diverse range of sectors and geographies. Here are a few examples of efforts that are achieving some success at scale.

CLEAN TECHNOLOGY—Once a niche interest of philanthropists, the sector has grown tremendously, with $148.4 billion of new investments in clean technology in 2007. Clean tech investments are the destination for more than 10 percent of venture capital funding, although much of this funding is purely profit-seeking and not motivated by impact. Among the many funds interested in clean tech are London-based *Generation Investment Management*, which integrates sustainability into equity analysis and closed a $638 million Climate Solutions Fund in 2008; and Connecticut-based *MissionPoint Capital Partners*, whose $335 million fund is focused on solutions for a low-carbon economy. Top venture funds Kleiner Perkins Caufield & Byers and Draper Fisher Jurvetson are also leaders in this space.

MICROFINANCE—Microloan volume has grown from $4 billion in 2001 to $25 billion in 2006. Successes within this rapidly developing sector include *responsAbility*, a Zurich-based advisory services firm founded in 2003 that is currently channeling more than $600 million in assets into microfinance, much of it from private banking clients and high-net-worth individuals. The first collateral debt obligation to be backed by a portfolio of loans to microfinance institutions was issued by the Swiss company *Blue Orchard*, which sold $87 million worth to private institutional and individual investors in 2004-5.

GLOBAL HEALTH—The *International Finance Facility for Immunization*, launched in 2006, raised up to $4 billion in triple A-rated bonds for the provision of vaccines that could save 5 million lives in the next 10 years. The bonds, which were 1.75 times oversubscribed, were backed by eight donor countries and managed by Goldman Sachs and Deutsche Bank. A number of newer funds, backed by experienced managers (e.g., senior executives from Putnam and Oxford Bioscience), have launched in the last 12 months seeking to combine financial return and mission impact.

SUPPORTING JOB CREATION AND SMALL AND MEDIUM ENTERPRISES IN DEVELOPING COUNTRIES—Successes have been launched using a range of funding sources. The large nongovernmental organization, *BRAC*, based in Bangladesh, uses enterprise investment-driven approaches to serve the poor at a massive scale and has created almost 7 million jobs through development interventions in Asia and Africa. *Grofin*, which was incubated by the Shell Foundation and has proved to be commercially viable, has more than $100 million invested in eight different funds, mostly in Africa; in 2008, it launched a new fund with $125 million of development finance money at its first fund closing. In South Africa, *Business Partners International* was launched as a business providing a full-service offering to entrepreneurs, including financing and technical assistance. It has invested $88 million, with more than 80 percent of deals in businesses owned by black entrepreneurs or women.

COMMUNITY DEVELOPMENT IN THE U.S.—The Community Reinvestment Act, originally passed in 1977, has provided incentives to dramatically increase investment in poor communities—a total of $26 billion was invested in the U.S. in 2007. *Self-Help*, a community development lender and real estate developer, has provided more than $5 billion by developing a secondary market for non-conforming mortgages that responsibly financed low-income home purchases. In 2007 alone, *Local Initiatives Support Corporation* made more than $1.1 billion in investments to revitalize low-income communities, and *Enterprise Community Partners* invested $1 billion in affordable housing and community development. *ShoreBank*, the first community development and environmental bank holding company, has grown dramatically, with $2.4 billion in assets as of the end of 2007.

Our purpose is neither to celebrate nor to simply warn of the dangers ahead. Instead, we hope to lay out what it would mean to set the bar high enough—to advance this emerging industry systematically, with demonstrable impact on urgent social and environmental issues.

moment of transition requires leaders to build the collective will that can only come from seeing the common whole that is emerging from diverse elements in this emerging industry. But at the same time, what is needed to accelerate progress is the ability to separate and make distinctions, so that action is meaningful on the ground.

Our purpose is neither to celebrate nor to simply warn of the dangers ahead. Instead, we hope to lay out what it would mean to set the bar high enough—to advance this emerging industry systematically, with demonstrable impact on urgent social and environmental issues.

Our focus on impact investing is in no way a diminution of the critical role of philanthropy or a view that impact investing can and should broadly supplant it. These times remind us how easy it is to slide into market triumphalism—where we lapse into the sloppy (and incorrect) thinking that investment and market mechanisms are the solutions to all our problems. However, the magnitude and nature of the problems humanity faces also require the harnessing of additional investment capital.

This report has been designed as a guide for the innovative leaders who can accelerate the progress of impact investing—investors, advisors to investors, entrepreneurs, philanthropists. It summarizes our findings about:

- *The current state and shape of the industry at a critical moment in its development*—so you can locate yourself in the current landscape, reflect on its opportunities and challenges, and understand what has catalyzed other industries at this phase of evolution
- *How impact investing might evolve*—so you can develop an understanding of what the future may hold, including the promise and tradeoffs of pursuing different strategies
- *An approach for accelerating the growth and impact of this style of investing*—so you can assess what you can do to seize the business opportunities inherent in it and understand what could be achieved by joining with others
- *A call to action*—so you can understand the importance of the moment and can develop a concrete sense of what success in building a marketplace for impact investing might look like in the months and years ahead

We will also try to bring the diversity within impact investing to life through examples and profiles of people engaged in doing it.

Despite the substantial disruptions in the general investment community that have left many people shell-shocked and others triumphal about capitalism's demise, impact investing innovation is proliferating. But only pioneering leaders can provide the talent, resources, and discipline that will be needed to create a coherent marketplace with high standards of impact. Working in an emerging area can feel isolating at times. Our hope is that this report will help you see yourself as part of something larger—and also inspire you to take part in ways you have not yet imagined.

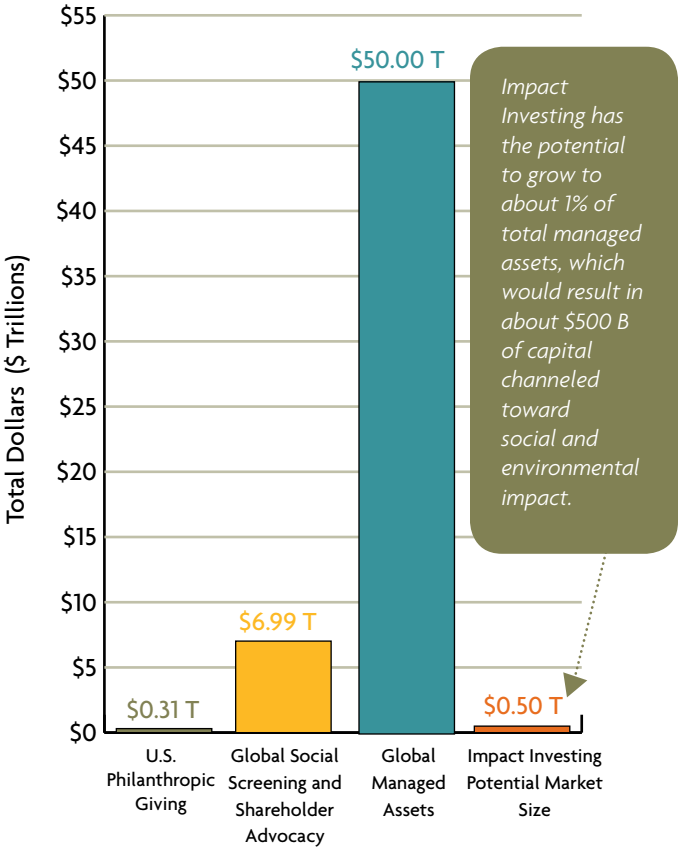
HOW BIG IS IMPACT INVESTING?[2]

Because this new style of investing is diverse and in a nascent stage of development, there is no way to tell exactly how big it really is. But the high level of activity and innovation in specific segments and geographies where data is available suggests that the industry is poised for growth.

Community investing refers to the provision of financial services to underserved communities and includes banks, credit unions, loan funds, and venture capital funds. It has taken hold in the U.S. and, more recently, in Europe. In the U.S it has grown to a total of $26 billion invested, with a compound annual growth rate of 22 percent between 2001 and 2007. The microfinance field globally has grown even faster, with the total volume of microloans growing at a 44 percent annual rate from 2001 and 2006 to reach $25 billion. Meanwhile, the volume of money coming into clean technology investments has quickly become a flood, growing to $148.4 billion of new investments in 2007, up 60 percent from the year before.

How much larger could investing for impact be, if leaders join together to build the marketplace infrastructure we outline in this report? Given the size of today's screened social investments, it is certainly plausible that in the next five to 10 years investing for impact could grow to represent about 1 percent of estimated professionally managed global assets in 2008. That would create a market of approximately $500 billion. A market that size would create an important supplement to philanthropy, nearly doubling the amount given away in the U.S. alone today (global figures are not available).

Comparative Market Sizing



Note: Social screening figures include some impact investing as well as negatively screened assets. Sources: Giving USA, Social Investment Forum, European Sustainable Investment Forum, and International Financial Services London. All data is based on reports issued in 2008 with data from 2007. Global managed assets adjusted to reflect market downturn. See endnote 2 for further explanation.

Recently it has become possible to see the disparate and uncoordinated innovation in a range of sectors and geographies converging to create a new global industry, driven by similar forces and with common challenges.

1 AN INDUSTRY EMERGES

The style of investing we are addressing here is not new. Pioneers in microfinance, community development finance, and clean energy—to name a few of the arenas already full of activity—have been hard at work for decades. And some leaders in what is broadly called social investing have long been experimenting with going beyond "negative screening" to investing in companies actively doing good.

But **recently it has become possible to see the disparate and uncoordinated innovation in a range of sectors and regions converging to create a new global industry, driven by similar forces and with common challenges**. This loose collection of investment activities—which operate in the largely uncharted area between philanthropy and a singular focus on profit-maximization—is still in search of a name. This report names the activity **impact investing**, recognizing the double meaning (investing for social and environmental impact, as well as the impact that this new approach could have on investing as a whole).[3]

Whatever name you give it (see sidebar, "A Tower of Babel"), its growth is being fueled in the headlines and behind the scenes by such actors as:

- Prominent family offices for the world's wealthiest individuals that actively seek to source, vet, and execute investments to address a range of challenges, from the perils of climate change to the suffering of people living in U.S. inner cities, African slums, or rural Indian villages.
- Clients of leading private banks who call on their investment managers to provide them with more choices than just traditional investment and pure philanthropy.
- Private foundations that partner with investment banks, development finance institutions, and other foundations to make investments in areas related to their social mission.
- Private equity funds that aim to provide growth capital profitably to businesses that generate social and environmental returns.

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

A Tower of Babel: Terms Currently Used

Socially Responsible Investing

Social Investing

Mission-Driven Investing

Sustainable and Responsible Investing

Blended Value

Values-Based Investing

Mission-Related Investing

Ethical Investing

Responsible Investing

Impact Investing

Program Related Investing

Triple-Bottom Line

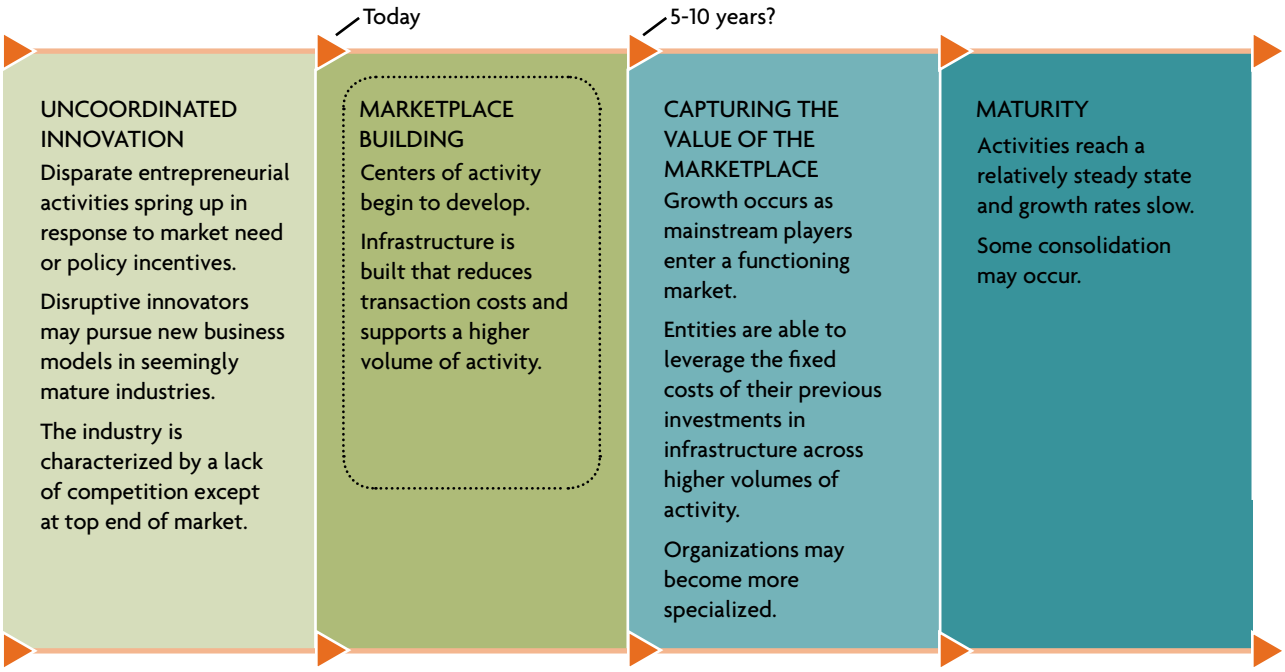
Environmental, Social, and Governance Screening

- Mutual funds that have dedicated a portion of their assets to emerging companies committed to generating social and environmental value or bond portfolios financing housing for low- and moderate-income families or other civic improvements.
- Pension funds and sovereign wealth funds that are using their substantial resources to begin identifying how to deploy capital in ways that benefit the communities they serve and recognize the power of the capital they invest.
- Corporations that find ways to materially improve the lives of the poor while creating products and services that generate a profit.
- Governments investing in funds that support economic development in poor areas.

This growing activity is generating excitement that has persisted despite the financial downturn of 2008. The business press is drawing attention to it, conferences are being convened to discuss it, and even Bill Gates has come up with his own catch-all category, "creative capitalism." And it is increasingly important, given that international private investment has vastly outstripped government and multilateral aid since the early 1990s.

A Critical Transition Point for Impact Investing: Building a Marketplace

Phases of Industry Evolution



Our research indicates that this emerging industry has reached a transitional moment in its evolution. It is poised to exit its initial phase of uncoordinated innovation and build the marketplace required for broad impact, as illustrated in the diagram of the prototypical phases of industry evolution.[4]

Movement through the phases is not linear. At times evolution may be slow; at other times there may be a jump forward or back. Sectors within impact investing—such as microfinance and community development finance—have moved through these phases at different paces, often taking decades for uncoordinated innovation to emerge and a decade or so to build marketplaces.

But for the first time it is becoming clear that these sectors as parts of a broader impact investing industry, using the definition of "industry" applied by strategy guru Michael Porter: a "group of firms producing products that are close substitutes for each another."[5] Increasingly, investors are looking for the best ways to achieve financial return and impact and are eager to source deals in diverse settings such as microfinance in rural India or community development in Los Angeles. At the same time, intermediaries initially developed to serve a specific sector are proving valuable platforms across multiple impact investing sectors. Actors who once saw themselves as engaging in different businesses are discovering that they are part of a broader emerging industry that is filled with uncoordinated innovation.

With coordinated effort and sufficient investment in infrastructure, investing for impact could move out of the phase of uncoordinated innovation and build the marketplace required for broad impact—potentially during the next five to 10 years.

The pace of evolution can be accelerated by pulling together the disparate players, creating a common language, and helping all see the opportunities and challenges they have in common. In the arena of investing for impact, that has been challenging and remains so. A variety of terms have been coined to articulate different ways in which financial capital can be harnessed to achieve a positive social or environmental impact. While impact investing overlaps with many of these other practices, the term refers to a specific type of activity. Clearly articulating the differences between impact investing and other practices reveals the specific types of investment that fit within its scope (see box, "What's Impact Investing Got To Do With It?").

Our research indicates that this emerging industry has reached a transitional moment in its evolution, poised to move from a phase of uncoordinated innovation and to build the marketplace required for broad impact.

WHAT'S IMPACT INVESTING GOT TO DO WITH IT?

SOCIAL INVESTING—Social investing is a term with many uses, but it generally refers to investing that considers social and environmental issues. Social investing includes investments made with the intention of having a positive impact, investments that *exclude* "harmful" activities, and investments that are driven by investors' values and don't necessarily correspond to having a positive social or environmental impact. *Impact investing is a subset of social investing; it refers only to the social investing that* actively *seeks to have a positive impact.*

PHILANTHROPY AND NONPROFITS—Philanthropy has traditionally focused on gifts made by individuals and organizations to benefit society and the environment. *Impact investing, with its requirement of a minimum return of principal, is distinct from grantmaking activities. Impact investing can however be an important vehicle for philanthropists to realize their objectives. Similarly, nonprofit organizations can act both as impact investors and as recipients of impact investments to enhance their impact.*

MISSION-RELATED INVESTMENT (MRI) AND PROGRAM-RELATED INVESTMENT (PRI)—MRI is a term coined recently to describe market rate investment by private foundation endowments that use the tools of social investing, sometimes including shareholder advocacy and positive and negative screening. PRI is below market rate investment by foundations, deeply focused on impact and counting toward endowment payout requirements for foundations in the U.S. *Impact investing includes all mission-related investing that actively seeks to have a positive impact (i.e. all MRI except for screening which is not often thought of as MRI). Almost any PRI would be considered a form of impact investing.*

BOTTOM OF THE PYRAMID—BoP refers to a broad set of business activities focused on the 4 billion people living on less that $2 per day. Different schools of thought within the BoP community advocate that the poor should be seen as potential consumers, producers, partners, and/or innovators. *Impact investing overlaps with some BoP activities to the extent that they involve investments with the intention of having a social or environmental impact for low-income communities. But impact investing does not assume that any investment in a business selling products to poor people inherently creates social impact.*

PRIVATE SECTOR ACTIVITY IN POOR COUNTRIES—Increasing private sector activity creates economic value but it is done with a variety of intentions. *Impact investing only includes those investments made with the explicit intention of having a positive social or environmental impact, such as job creation for low-income people. The fact that an investment is made in a poor country is not sufficient to qualify it as an impact investment.*

CORPORATIONS—Several terms have emerged that articulate the role of corporations in addressing social and environmental problems. **Corporate Social Responsibility (CSR)** is defined as the integration of business operations and values, where the interests of all stakeholders—including investors, customers, employees, the community, and the environment—are reflected in the company's policies and actions.[6] Special attention is given to corporate practices as they relate to environmental, social, and governance (ESG) performance. **Creative capitalism**, a term publicized by Bill Gates, advocates for a new form of capitalism in which companies harness market forces to generate profits while addressing social and environmental problems. Nobel Prize winner Muhammad Yunus, the founder of Grameen Bank in Bangladesh, advocates a proliferation of "social businesses" that harness corporate capacities in a new business form that seeks sustainable financial returns without substantial profit. These concepts include financial investments as well as other activities focused on shifting the behavior of corporations. *Impact investing only includes those activities focused on the deployment of capital with the intention of having a positive social or environmental impact.*

INCLUSIVE BUSINESS—Inclusive business refers to sustainable business opportunities that are profitable and benefit low-income communities. These companies may also be considered social purpose businesses or social enterprises. Examples include direct employment of the poor, often through targeted development of supply chains, and the provision of affordable goods and services to them.[7] This concept has significant overlap with creative capitalism, CSR, and BoP. *Impact investing includes the subset of inclusive business activities that involve the deployment of capital with the* intention *of having a positive social or environmental impact.*

What's Creating This Moment?

Impact investing is being propelled by a powerful set of opportunities that appear likely to continue or even strengthen despite the capital market shocks that began in 2007. **But there are also many existing challenges that stand between the promise and the reality for impact investors, and these will need to be tackled for the industry's development to accelerate**. Based on our interviews of more than 50 impact investors, we have distilled those themes into four opportunities and three challenges, each of which is described in more detail below.

The global financial crisis has the potential to amplify some of these opportunities and challenges. In the short term and on the downside, it will likely dampen interest among potential investors not yet engaged, who may retreat to conservative investing. General mistrust of markets and market innovations as a result of the crisis could also constrain the development of investing for impact.

On the other hand, a macroeconomic slowdown may make impact investing more attractive for those already engaged—particularly those who are driven primarily by impact—because it helps diversification and assets are relatively cheap after the market drop in 2008. Given how seriously the market has mispriced risk, the expectations of appropriate return for appropriate risk may be changing, and this may render impact investing more attractive (for example, if relative risks such as poor governance are lower). The lack of opportunities in traditional financial markets will likely increase the ability to recruit high-level talent into investing that has a purpose beyond making money. Moreover, there is tremendous potential upside if the inevitable government regulation that results ends up encouraging investment that takes into account other factors besides financial gain.

The net effect of the economic climate on investing for impact is impossible to predict. But what is certain is that most of the following opportunities will persist—and the following challenges will need to be surmounted.

Opportunities:

- Growing interest among capital providers
- Greater recognition of the need for effective solutions to social and environmental challenges
- A steadily developing track record with early successes
- A flock of talent

Challenges:

- Lack of efficient intermediation
- Lack of enabling infrastructure
- Lack of sufficient absorptive capacity for capital

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.

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 a 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 benefits 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.

OPPORTUNITIES

Investors are seeking a new approach to money management that enables them to also "make a difference."

1 **OPPORTUNITY: Growing interest among capital providers.** Even in the economic climate in 2008, there was interest in putting capital to work. The desire for diversification is leading investors to look at sectors like microfinance, which tend not to be correlated with the broader market.[8] In particular, much of the interest in impact investing is being driven by a growing set of investors who have recently become very wealthy and are seeking a new approach to money management that enables them to also "make a difference." As Charles Ewald of San Francisco-based New Island Capital points out: "This is the first time that so many enormous fortunes have been created by people so young. They have institutional scale and a long horizon." And as Chris Wolfe, a private banker at Merrill Lynch, explains, "The ultra-high-net-worth individual category has been a driver and leader in this type of investing since they have the capacity, ability, and time to understand what impact investing means." Some of these investors are also increasingly disenchanted with mainstream investment products (and financial capitalism at large). Impact investing can be more appealing to them than conventional models of philanthropy and investing, and these investors have sufficient scale and flexibility to be early movers in the space.

Interest is also being driven by an increasing focus on rapidly growing markets such as India, China, and South Africa, where investments tend to have a stronger connection to public benefit through opportunities like building basic infrastructure or spurring economic development constrained by access to capital. There are also investment opportunities focused on providing products and services to the poor, in emerging markets and in developed countries as well (e.g., in inner cities). A subset of these opportunities has the potential to create material social or environmental benefit.

Increasingly, consumers are incorporating values-driven considerations into their purchasing and investment decisions, leading to investment opportunities in areas with increased demand such as organic, fair trade, and green products. And like consumers, investors are also seeking to make investments that are aligned with their values. As Scott Budde, head of social and community investing at the U.S. pension fund TIAA-CREF, explains, "Client demand is a key driver behind TIAA-CREF's socially motivated investing strategies. The fact that both social screening and proactive investing programs continue to yield competitive returns allows these strategies to thrive."

At the same time, interest in impact investing in some regions and sectors has also been pushed by regulatory incentives and mandates, such as the Community Reinvestment Act in the U.S. and the Dutch Green Funds Scheme. There is also great interest in impact investing coming from investors who anticipate future changes like carbon pricing and want to take advantage of an

PROFILE: **INTELLECAP**

Firm Builds the Intellectual Infrastructure for Inclusive Capitalism in Emerging Markets

SNAPSHOT

HOW IT BEGAN: The founders of Intellecap wanted to harness interest in market-based solutions to social problems and to combine the rigor of investors with the passion of social entrepreneurs. They founded Intellecap in 2002 as a pioneering social investment bank to bridge the gap between capital and social businesses. Intellecap's initial capital outlay was just $2,500 and it was focused on supporting the growth and intermediation of investment in microfinance. Intellecap now has a global team of more than 55 professionals focused on developing the intellectual infrastructure to build and nurture emerging businesses across sectors that generate financial returns as well as social and environmental impact.

SECTORS: Microfinance, energy, financial services, agriculture, technology, banking for financial inclusion, education, and health

GEOGRAPHIC FOCUS: South Asia, Southeast Asia, Middle East, and Africa

BASED IN: India, Europe, and the U.S.

YEAR: 2002

CAPITAL DEPLOYED: More than $100 million in deals closed

BUSINESS THESIS: "To intermediate social capital in order to catalyze the growth of for-profit social businesses and to provide a nurturing ecosystem for leading for-profit social entrepreneurs worldwide."

PERSPECTIVE

From Vineet Rai, Pawan Mehra, and Upendra Bhatt, co-founders

OPTIMISM: "While we continue to meet a lot of skeptics, we are optimistic because of the changing landscape in the development sector, with donor capital being replaced by social capital and information being replaced by useable knowledge. The combination of the talent and innovation is spurring the discovery of new vistas of intervention and new ways of creating common interaction points, resulting in wider outreach and more effective outcomes."

POTENTIAL FOR LEADERSHIP: "We believe one can take money much further by providing large foundations and investors quicker outreach to more effective social entrepreneurs. Intellecap's uniqueness emerges from its ability to understand and effectively work with both ends of the spectrum—the buy side through to the sell side."

NEED FOR INTERMEDIATION: "Knowledge leads capital. Capital needs to find the right opportunities and receive the right advice to take advantage of the opportunities. We help create useable knowledge in the development sector to help social investors make right choices. We engage over the long term with closure of a deal marking the beginning of a relationship."

TIME HORIZON: "Patience is our virtue. We believe development investing and intermediation is not an opportunistic intervention but needs patience for impact to materialize—impact can't be achieved in two or three years. This is a long-haul game and we shouldn't expect results soon. We must stay committed to learning and making progress."

CHALLENGES:

"Talent is a critical need. You need talent of a much higher order than what is needed for mainstream investing because this space is much more complex and it demands creative solutions. You must retain talent for a long period of time to build scale and sustainability in development."

"Investors prefer following over leading. Social investing is about leadership and being in the front seat. Unfortunately even social investors are not willing to accept failure and they thus reduce the ability of social entrepreneurs to experiment with risky solutions that have the potential for being more effective. There is too much fear of failure."

IF IMPACT INVESTING WERE A MATURE INDUSTRY . . . "Investors would appreciate its complexity. Scale would incorporate the impact and not just the amount of money invested, impact would be defined by considerations beyond the number of people affected, solutions would not be banished from discussion, and partnerships amongst diverse investors and actors would emerge to bring optimal solutions to the needs of the world's poorest."

underpriced opportunity. As David Chen of the investment firm Equilibrium Capital sees it, "The policy environment in Europe has created awareness around topics that the U.S. is just beginning to catch up to."

These daunting social and environmental challenges are leading some investors to seek new approaches and investment opportunities that can help provide solutions.

2 **OPPORTUNITY: Greater recognition of the need for effective solutions to social and environmental challenges.** Social and environmental issues and growing inequity are increasingly urgent and often more visible. More than a billion people around the world still live in extreme poverty, and millions more are barely pulling themselves out.[9] In urban centers around the world, dramatic inequity is barely screened by the security gates that separate the estates of the very wealthy from the shantytowns of the very poor. The melting Arctic provides a salient reminder that carbon emissions are threatening the very ecosystem that humans depend upon. Headlines make these issues harder to ignore, whether they're about poverty in the U.S. (Hurricane Katrina in 2005) or the gradual mainstreaming of microfinance for the poor (the Nobel Prize won by Grameen Bank founder Muhammad Yunus in 2006). Similarly, growing publicity about climate change has been spurred in part by Al Gore's book and movie, "An Inconvenient Truth" and the Nobel Prize awarded to him and the UN Intergovernmental Panel on Climate Change in 2007. These daunting challenges are leading some investors to seek new approaches and investment opportunities that can help provide solutions.

3 **OPPORTUNITY: A steadily developing track record with early successes.** Early successes in community development, microfinance, and clean tech are attracting positive and extensive popular press and broader interest in impact investing. Lucrative impact investments have attracted significant investor interest in the space. The Compartamos initial public offering in early 2007 yielded original investors an internal rate of return of 100 percent a year compounded over eight years; return on equity in 2007 was more than 45 percent.[10] A board director at Banco Compartamos, Álvaro Rodríguez Arregui, has now partnered with Michael Chu, formerly of Kohlberg Kravis Roberts and former president and CEO of microfinance leader ACCION International, to launch IGNIA Partners, a venture capital firm focused on health, housing, and education companies that serve the poor in Latin America. As Kyle Johnson, an investment advisor at Cambridge Associates, explains, "Success stories such as the microfinance industry have led to people re-evaluating how commercial markets can be used for social good." Several clean technology investments have also demonstrated that impact investments can yield financial returns and impact simultaneously.

4 **OPPORTUNITY: A flock of talent.** Young professionals are increasingly interested in impact investing and in creating businesses that have social and/or environmental impact. For example, when J.P. Morgan launched its social

sector finance unit in 2007, its leader Christina Leijonhufvud reports, "We received about 1,000 résumés from employees in other units who were interested in positions with our group or contributing their time to our efforts." Net Impact, an international network of MBAs and other graduate students and professionals interested in social enterprises, now has more than 10,000 members. At Harvard Business School, more than 20 percent of students in 2008 were members of the student-led Social Enterprise Club. The rise of the concept of social entrepreneurship reflects significant interest in working in this arena and has, in turn, created greater institutionalization of academic and professional resources for those pursuing related activities. This infusion of talent will lead to higher-quality investment opportunities as well as more effective intermediaries and service providers over time.

While these opportunities are supporting an increase in impact investing, there are also significant barriers constraining the level of investment. These challenges relate to the rigidity of the investment industry as well as the weakness of market infrastructure for impact investing.

CHALLENGES

1 **CHALLENGE: Lack of efficient intermediation.** The lack of mechanisms to connect capital and impact investment opportunities is caused in large part by an investment industry structured around the historical binary of philanthropy (for impact) and investment (for returns), with optimization around each independently. As a result, the market for impact investing activity that integrates doing well and doing good lacks sufficient intermediation—whether it is clearinghouses, syndication facilities, independent third-party sources of information, or investment consultants. As a result, search and transaction costs are high, with fragmented demand and supply, complex deals, and underdeveloped networks.

Search and transaction costs are high, with fragmented demand and supply, complex deals, and underdeveloped networks.

Few institutions exist that can offer advice to people looking to do something different. Some fund managers are reluctant to seek more than just financial return since, as one of them put it, "people don't want hippies managing their money." Conservative investment advisors lack incentives to take risks in their investment approach and are concerned that incorporating social and/or environmental considerations might violate their fiduciary responsibility. As Steve Schueth of the U.S. investment advisory firm First Affirmative Financial Network describes it: "The real issue is not about products or markets; it's about attitudes in the board room and among advisors. . . . There's plenty of quality product on one end of the hourglass and lots of prospective clients on the other end. In the middle, there's a bottleneck and that bottleneck is the investment professionals in this country." A financial services provider in Europe made a similar point before the financial markets plummeted in

PROFILE: **JAY COEN GILBERT**

High-Net-Worth Individual Invests to Alleviate Poverty

SNAPSHOT

HOW IT BEGAN: In late 2001, several personal experiences led Jay and his wife to rethink how they managed their money. Initially they chose to go beyond their philanthropic activity by investing the funds in their charitable foundation in an actively managed socially responsible investment portfolio. In 2003, they placed approximately 5 percent of the foundation corpus into mission-related investments. Their first impact investment was a private equity investment in a fair trade, shade-grown organic coffee company which also donates 100 percent of profits to support the communities from which they sourced their beans. After a family sabbatical, they decided to focus all of their assets on alleviating poverty, hoping 20 percent would also have environmental impact. In 2006, they moved 100 percent of their assets out of conventional investments and they are now active impact investors.

SECTORS: Poverty alleviation (across various sectors)

GEOGRAPHIC FOCUS: Global

BASED IN: U.S.

YEAR: 2003

SIZE OF FUND: $5–10 million

INVESTMENT THESIS: Maximizing impact while preserving real capital

PERSPECTIVE

OPPORTUNITY IN COMMUNICATING THE IMPACT: "Impact and social change have emotional resonance in a way that financial returns do not. As a result, through the individual experience and shared stories of successful impact investing, people will become more engaged with their money and its potential end use, and over time will apply a greater portion of their time, talent, and relationships toward activities whose central purpose is to achieve social impact."

POTENTIAL FOR LEADERSHIP: "Networks are beginning to fill gaps. Investors' Circle has been successful at catalyzing some capital and many ideas but has been limited in its effectiveness in building infrastructure that can drive the field. The Global Impact Investing Network initially had the feel of an investment club but is now developing into a platform that can help advance the industry's evolution through, among other things, the creation and adoption of standards."

CHALLENGES:

"I have heard from many individual investors that they need a way to quantify the non-financial impact of their money. People find it difficult to justify even the possibility of a submarket rate of return without more clarity about the impact of the investments."

"Metrics are spotty—for a given intermediary they are often internally incomplete, and for the field they are inconsistent among intermediaries. We need to find a path toward transparency and comparability that preserves each investor's flexibility at driving toward their individual impact investment objectives."

"There are very few advisors for high-net-worth individuals who are really specialized and experienced in this space, so it is hard to get advice on high-quality funds and investment opportunities. With our advisor we had to invest a lot of time learning from scratch; it was a haphazard process."

"Investments have been more opportunistic than strategic because we had to work to find good product. There was no place we could go to find a breadth of options from which we could just construct a portfolio."

IF IMPACT INVESTING WERE A MATURE INDUSTRY . . . "Investors could approach their advisors and say 'I want to accomplish X impact objective' and the advisor could develop a comprehensive investment strategy that fit their objectives. Furthermore, the impact could be quantified with the same level of rigor and credibility as conventional investing."

2008: "Trustees are extremely conservative and are more prepared to invest in a hedge fund they don't understand than to invest in a mission-driven fund they don't understand."

The bifurcation of financial return and impact inhibits the integration inherent to impact investing. If history is part of the barrier, youth may be one element of the change. As one asset manager notes, "We need a new generation of money managers who are open-minded to the possibility that values and returns are not bifurcated."

The lack of intermediation also makes the technical complexity of deals more of a challenge. Some investors are discouraged by impact investing because of the difficulty involved in trying to have a positive social and environmental impact and to structure deals with different types of capital and investors.

Well-developed informal networks could compensate for this lack of formal intermediation. But those networks are underdeveloped because actors do not identify as part of an industry and therefore have difficulty trying to find peers. As Stephen DeBerry at Kapor Enterprises notes, relevant interest groups need to be developed further: "We need to form meaningful categories of interest so that existing and new impact investors can effectively find their relevant peers. Silicon Valley venture investors have done this organically and effectively. We should do the same."

Without a mechanism for aggregation, individual investors struggle to find investment opportunities that are at sufficient scale to justify the fixed costs incurred for sourcing the investments and conducting due diligence. Pools of capital are often large and investors must write big checks, while individual deals are relatively small. This makes impact investing less attractive to investors who are unable or unwilling to invest the additional effort required to source what may be relatively smaller deals.

Without a mechanism for aggregation, individual investors struggle to find investment opportunities that are at sufficient scale to justify the fixed costs incurred for sourcing the investments and conducting due diligence.

2 **CHALLENGE: Lack of enabling infrastructure.** Still an emerging industry, impact investing lacks the models, theories, policies, protocols, standards, and established language that would enable it to flourish. Many investors and intermediaries do not understand the implications of social and environmental considerations on the underlying risk of an investment opportunity—and there is a preconception that there must be a fundamental tradeoff between financial returns and impact. But there are no metrics or ratings agencies to help make relative financial risk and social or environmental impact more transparent. Furthermore, the financial performance of many impact investments is uncertain, even though these investments might meet or beat return benchmarks. These factors all make valuation quite challenging.

The market environment and infrastructure (e.g., regulatory, legal, tax) is highly structured around conventional investing, which constrains actors who are trying to engage in impact investing. For example, contracts or charters

may require modifications in order to allow investors to consider social and environmental outcomes. Furthermore, the distribution channels that help syndicate rated deals that are on approved buy lists do not help this new class of investment, which may not conform to standard channels. Distribution channels and custodial arrangements—in effect, the plumbing of the securities industry—often preclude interested investors from purchasing and clearing investments and custodians may be unwilling to hold such nonstandard assets.

Distribution channels and custodial arrangements—in effect, the plumbing of the securities industry—often preclude interested investors from purchasing and clearing investments.

The absence of coherent identification as part of an industry results in the use of varied terminology and diverse approaches causing difficulty in communicating. The lack of universally accepted vocabulary and market segmentation makes it difficult for impact investing actors to communicate about opportunities. The diversity of approaches and ways of describing them makes it difficult for actors to locate themselves in the impact investing ecosystem and to identify potential partners. As Preston Pinkett, the director of Prudential Social Investment, which had $400 million in investment commitments before the 2008 market downturn, explains: "It takes consistency in language to create a business. The biggest challenge is to have a coherent set of terms and phrases that are clearly defined and have clear meaning."

3 **CHALLENGE: Lack of sufficient absorptive capacity for capital.** In some sectors and regions there are plenty of deals in which to place money. But even in those places an imminent challenge will be whether there is sufficient deal flow, particularly large, bankable opportunities into which investors can place significant amounts of capital. Based on our interviews, although sufficient absorbtive capacity for capital is not the initial barrier in most places, it will soon become one; it is already a challenge in such markets as India, where lots of capital is seeking deals. Some investors are finding that there are few businesses with proven investable business models and that they are stopping at the same 50 doors as other investors.

One layer down there may be many homegrown seed opportunities developed by entrepreneurs and nongovernmental organizations that need to be commercialized (as happened with microfinance), but they tend to face a number of challenges. Serving the poor is typically relatively expensive, and there is often a need to invent new and disruptive business models, which existing players lack an incentive to do. The banking system does not effectively serve small and medium enterprises, where many impact investing innovations are taking place. And these organizations often need some combination of working capital, debt, and equity. They may also lack an effective and scalable business model. Funds such as GroFin and the Small Enterprise Assistance Funds, which aim to invest in sustainable development by supporting medium-scale businesses in developing countries, have needed to build substantial capacity to support entrepreneurs before and after investment with basic business training and strategic advice.[11]

In some places, businesses that serve the poor are starting to draw attention, especially as opportunities to serve more affluent populations become crowded with competitors and entrepreneurs start to head down market (for example, in India, moving from developing malls to the high-volume opportunities in low-income housing).[12] But the runway for development of these investment opportunities is long, and some businesses will take several years before they can be investable, and about 10 to 15 years before they are able to operate at broad scale.[13]

How to Build a Marketplace: Lessons from Other Industries

As a result of this mixture of opportunities and challenges, a transition is underway—impact investing has achieved a critical mass of innovation and now has the potential to move toward the next phase of its evolution. For this transition to happen, the barriers that keep the old patterns entrenched must be removed.

These types of barriers are common challenges in emerging industries, particularly the related fields of microfinance, community development finance, and venture capital/private equity. Experience in these industries suggests that the challenges cannot be overcome unless industry leaders work individually and collectively to remove the barriers that keep the old patterns entrenched. Only then can an industry move more quickly from a phase of innovation to a phase of value capture. Policy change has also been a critical ingredient in the development of many of these other industries. At the same time, there are also cautionary tales about the challenge of this transition in examples of innovations that never took off.

Some of the most relevant lessons can be drawn from **microfinance**, an industry that has only recently reached this transition. A subset of impact investing, microfinance became more mainstream in the mid-2000s and started to move out of the marketplace building phase. Its success has been characterized by initiatives that built critical elements of the infrastructure to attract a broader set of actors and capital to the table.

The first microfinance institutions were founded in the 1970s—most of them by nongovernmental organizations—and over the course of more than a decade these institutions began to demonstrate the viability of the sector. Although there were decades of innovation and a proliferation of models, the industry did not start to achieve nonlinear growth until it solved some of the infrastructure issues that are part of building a marketplace—thereby attracting the large, powerful traditional finance industry players who have helped dramatically grow the market.

In the 1990s, *more sophisticated measurements of performance and impact emerged, with a greater emphasis on standardization.*[14] *These efforts were partly a result of the increased strength of industry associations*, including the Small Enterprise Education and Promotion (SEEP) Network, a membership organization of international

Lessons About Building the Marketplace

MICROFINANCE

Improved mechanisms of coordination (through industry associations, for example) can enable improved flow of information and formation of partnerships.

Standardization of terms and basic metrics for performance comparison can lay the groundwork to attract a dramatic influx of capital from large traditional financial institutions and help capital providers and recipients focus their resources.

While profit-seeking behavior can attract greater mainstream investments, it also generates **concern about how low the floor for social impact is.**

COMMUNITY DEVELOPMENT FINANCE

Creating an industry coalition can help advance collective interests, including spurring the **establishment and enforcement of policy.**

Developing innovative products can attract capital by enabling broader access.

VENTURE CAPITAL/ PRIVATE EQUITY

Policy change can help unlock institutional capital—and that increased supply of capital can spur market evolution.

Investors may initially need to weather a **cycle of learning before a success formula is worked out**—once it is, **well-publicized successes** can help attract capital.

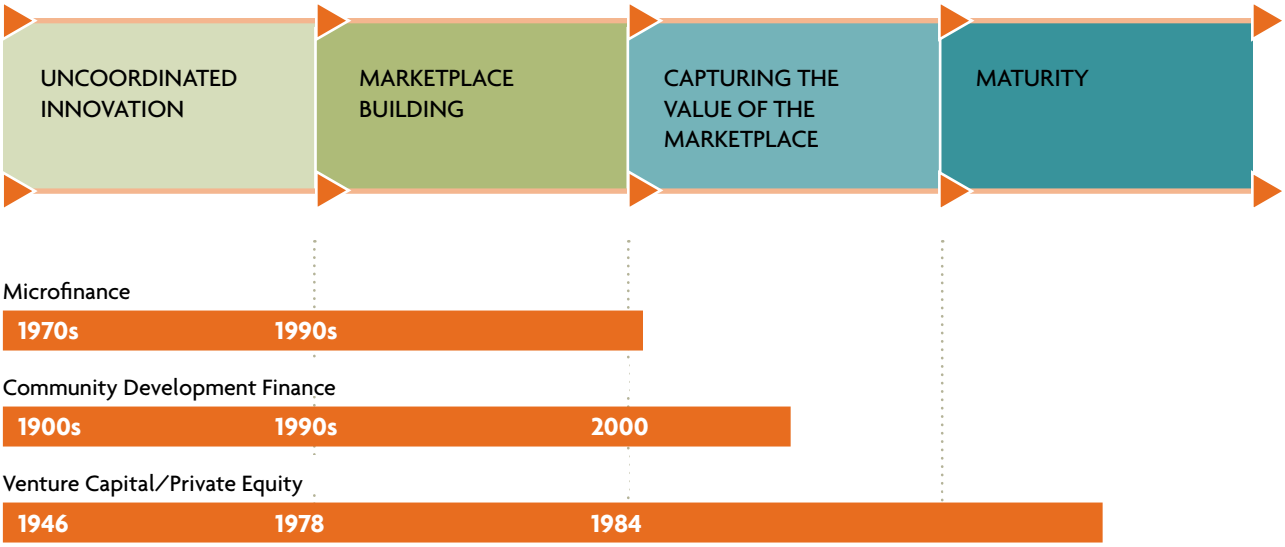
The history of the evolution of other industries suggests that these challenges cannot be overcome unless industry leaders work individually and collectively to remove the barriers that keep the old patterns entrenched.

nonprofits with microfinance programs, and the Consultative Group to Assist the Poor (CGAP), an independent membership body housed at the World Bank consisting of development agencies, financial institutions, and foundations.[15] In a positive, reinforcing cycle, increased interest in microfinance led to the emergence of market-building infrastructure. In 1996, MicroRate, one of the first dedicated microfinance rating services, was launched. Around that same time, the MicroBanking Bulletin developed a robust data set that made possible the industry standards and norms necessary for the formation of performance benchmarks. And in 1997, the first Microcredit Summit was held to share knowledge and best practices and to work toward reaching 100 million of the world's poorest families.[16]

The results of these activities have, in turn, *attracted mainstream financial service providers*. In 2008, Standard & Poor's announced plans to formulate global risk ratings for microfinance institutions.[17] Microfinance has gained the attention and support of return-oriented investors, and the microloan volume has grown from $4 billion in 2001 to $25 billion in 2006.[18] But *with this wave of capital has come concern about the social impact actually being achieved with profit-maximizing capital* in terms of how clients are selected (seen by some as skimming off the least poor clients) and the interest rates at which loans are made (seen by some as predatory lending).

Accelerating Industry Evolution

A Tortoise or a Hare?: The Pace of Evolution for Different Industries



PROFILE: **INVESTING FOR GOOD**

Firm Helps European Wealth Advisors Connect Clients to Impact Investments

SNAPSHOT

HOW IT BEGAN: Investing for Good was founded by individuals who, after years working in the financial services sector, came to believe that poverty, destitution, and environmental damage are not inherently the problem—they are symptoms of capital markets that systematically disregard long-term downstream consequences. They became inspired by the new breed of entrepreneurial organizations that directly tackle the world's most pressing problems but realized that financial advisors, financial intermediaries, and asset managers lack the capacity to advise appropriately on deals in the impact investing space. They developed a business to provide investment advice and market information to support investment advisors offering their customers access to the world of social investing.

SECTORS: Moving toward developing funds with a primary social and/or environmental impact focus across a range of sectors.

GEOGRAPHY: Global

BASED IN: U.K.

YEAR: 2004

CAPITAL DEPLOYED: Total amount is expected to grow from $15 million in 2008 to $50 million annually. Clients typically invest $100,000 or more, and deal size ranges from $100,000 to $100 million.

BUSINESS THESIS: Investing for Good's investment philosophy is grounded in a belief that the management of all investment portfolios should be more aligned with investors' core values and the opportunity to make a positive impact through investing. They target investments that emphasize social impact with some financial return. Investing for Good researches and tracks these investments and has developed a unique rating criteria based on confidence, financial return, and social metrics, with the goal of providing 'off-the-shelf' products for advisors. Most portfolios are built around debt instruments or funds and typically pay out 4 to 6 percent.

PERSPECTIVE

From Geoff Burnand, chief executive

NEED FOR SOCIAL METRICS: "As the impact investing market becomes more popular, there is going to be a demand for social metrics to justify one investment over another. Capital market activity will follow if the data and metrics piece evolves."

NEED FOR INFRASTRUCTURE: "There is a need for consistent language and appropriate mainstream investment products to enable the wealth management community to understand the interrelationship between impact, financial return, and investment risk."

CHALLENGES:

"The evolution of the U.K. market was initially hampered by the lack of interest on the supply side. Now, the constraint has shifted toward demand-side issues and finding sophisticated products and high-quality deals."

"Although movement is taking place in the impact investing sector, we need critical mass to interest markets. We also need those already in this sector to not look toward themselves for all the answers and for future growth."

IF IMPACT INVESTING WERE A MATURE INDUSTRY . . . "Investment advisors would have the capacity, tools, and information needed to support their clients' impact investing interests as easily as they support conventional investing."

A coalition representing the collective interests of the industry helped accelerate the evolution of community development finance.

By comparison, **community development finance** in the U.S., another subset of impact investing, was catalyzed largely by many years of grassroots advocacy and policy change. Central to the industry's evolution was *a coalition that represented the collective interests of the industry, especially around policy and the development of products that enable broader access*.

While community development finance is not yet a fully mature industry, it has a long history, beginning in the early 1900s with the proliferation of community-based depository institutions. However, it was not until 1977, when the Community Reinvestment Act (CRA) was passed, that the movement progressed significantly in the U.S. Created to encourage banks to serve poor communities better, particularly through the provision of credit to support small businesses and affordable housing in low-income communities, the CRA exists because of significant grassroots pressure.[19] In the early years though, CRA resulted in only marginal changes in the practices of some banks as enforcement was relatively limited. This began to change, however, with the increasing number of bank mergers and acquisitions in the early 1990s.[20] The desire for regulatory approval for these mergers and acquisitions gave banks an incentive to improve their CRA ratings.

Although the CRA was a result of strong grassroots activism responding to significant disinvestment by the financial sector in low-income and/or communities of color, additional policy changes were realized with the 1992 founding of the Community Development Finance Institution (CDFI) Coalition. This was the first organization that brought together different community development financial institutions from all over the country to enhance their national profile through policy development and advocacy. One significant result of the Coalition's work was the establishment of the CDFI Fund in 1994. This U.S. Department of Treasury program has become the largest source of both debt and equity capital for CDFIs and plays an important role in attracting and securing private dollars for community investment. As of 2006, cumulative Fund awards were $800 million and the realized leverage on the CDFI Fund's required dollar for dollar match is even greater. For example, in 2005, the CDFI Fund awards leveraged $27 of private-sector investments for every $1 of federal investment.[21]

As the field has grown, other regulatory changes and products have emerged, including tax credits that create incentives for investments in affordable housing and economically distressed areas, CRA-related mutual funds, and a secondary market for community development finance originated loans. Also, major financial institutions have developed CDFI subsidiaries and other financial sector entities have created products that invest assets in community development financial institutions. These policies and financial products have supported the development of the field that in 2006 held more than $23 billion in assets and invested more than $4 billion annually to create economic opportunity.[22] (Although some opponents of CRA have tried to use the subprime crisis as justification to attack the Act, the consensus is that the crisis is completely unrelated to CRA. Subprime loans were

generally originated by institutions not subject to CRA, CRA loans were not securitized, and CRA loans and securities are, in fact, performing reasonably well.)[23]

Today, there is evidence that with the merging of CDFIs, the industry is moving out of the marketplace building phase and into the value capture phase. Thus, the lessons for impact investing—creating a coalition that represents the collective interests of the industry especially around policy and developing products that enable broader access—may be powerful approaches to developing the marketplace.

A more mature industry to mine for lessons is **venture capital and private equity**. The first private equity company, American Research & Development Corporation, was founded in 1946. In the 1950s, U.S. government legislation gave rise to specialized, privately funded investment firms that provide capital to early-stage companies. While both types of firms had underwhelming results and failed to generate excitement from mainstream investors, they ultimately produced capable investment advisors who formed partnerships that achieved enormous success later. The pioneering efforts of early adopters provided a forum in which venture capital entrepreneurs gained valuable experience—and impact investors *may need to weather a similar cycle of learning before the successful formula is worked out*.

Government policy and tax incentives played a significant role in driving a supply of capital that accelerated the evolution of the venture capital and private equity industries.

Government policy and *tax incentives* also played a significant role in driving supply of capital for investment. An increase in the capital gains tax in 1969 restricted the inflow of funding into private equities in the 1970s. But in 1978, the federal government changed the Employee Retirement Income Security Act, enabling pension funds to invest in venture funds and thereby dramatically increasing the supply of available capital. In addition, Congress lowered the capital gains tax rate significantly.

This confluence of factors contributed to strong growth; venture capital investments grew from $600 million in 1980 to $3 billion in 1984. In the mid-1980s, *much-publicized successes* such as Apple Computer's $1.3 billion initial public offering helped attract more capital from previously unconvinced investors.[24] At the same time, *market innovations* such as leveraged buyouts and mezzanine funding created other types of financing that would later grow to be six times that of the venture capital industry in assets under management.

Although microfinance, community development finance, and venture capital/private equity developed in different ways and at different speeds, they are all models of successful evolution. But there is also a risk that, like a different set of products and industries, impact investing could flame out while in the phase of uncoordinated innovation. The catalogue of **product classes or industries that are launched but never take off** is long. Impact investing could be a premature idea, like the videophone, which failed to take hold in the marketplace at least four times. Or the bubble of hype may burst if impact investing proves to be the right concept but the wrong idea—much like the Segway, which was designed to revolutionize personal transportation but proved too dangerous for sidewalks and too slow for streets.[25]

There is a risk that like other industries, impact investing could flame out while in the phase of uncoordinated innovation.

These lessons help us understand how other industries have developed and what it will take to build a successful marketplace. But how might these experiences be applied to impact investing? Who would be involved? And what are the possible evolutionary paths this emerging industry might take?

PROFILE: **TRIODOS BANK**

European Bank Offers Suite of Impact Investing Products to Retail and Institutional Investors

SNAPSHOT

HOW IT BEGAN: In 1968, a study group began to explore how money could be managed sustainably. The Triodos Foundation formed in 1971 to support innovative projects and companies, and in 1980 Triodos Bank was founded as a licensed bank in the Netherlands. The bank has continued to expand to other European countries and launched a variety of financial products.

SECTORS: Renewable energy, microfinance, organic farming, nature conservation, sustainable housing, fair trade, and culture

GEOGRAPHIC FOCUS: Western Europe and emerging economies

BASED IN: Netherlands, Belgium, the U.K., and Spain, with an agency in Germany

YEAR: 1980

SIZE OF FUND: EUR 900 million across several impact investing funds with an additional EUR 400 million in traditional socially responsible investment funds.

INVESTMENT THESIS: To finance companies, institutions, and projects that add cultural value and benefit people and the environment, with the support of depositors and investors who want to encourage corporate social responsibility and a sustainable society. With the exception of specific funds developed for NGO partners, all funds offer a market-rate financial return.

PERSPECTIVE

From Bas Ruter, managing director, Triodos Fund Management

INVESTMENT OPPORTUNITIES: "Up until one to two years ago we had an excess of supply. Now the number of investment opportunities is growing much faster than the supply of investment capital in sectors like renewable energy, real estate, and microfinance. We are expanding our marketing department to help raise capital for all of our funds."

VISIBILITY: "The climate change debate has driven up the number of projects in recent years. Simultaneously, the brand equity of banks like Triodos has gone up and now the press is much more interested in impact investing."

INVESTOR INTEREST: "On the institutional side, the whole debate of being a responsible investor is shifting from negative screening toward an increased interest in alternative asset classes with sustainable development in a competitive risk/return profile."

CHALLENGES:

"The most important challenge is that the investment process is much more intensive. It is like building up a new portfolio: it takes a lot of time and is labor-intensive. We charge competitive management fees to our customers, but we have a lower margin than typical funds."

"There is a risk of the hype driving people to bad product, which will hurt the field. Investors need to understand the difference in quality and impact of the products being offered. We will have to develop criteria for investing and we will need more transparency. Certification schemes and legislation can help maintain standards."

IF IMPACT INVESTING WERE A MATURE INDUSTRY . . . "In all of our sectors, the scale will be higher. There will be more professionalism as it becomes more mainstream. Competition will be much more fierce and many opportunistic players will be entering the field, just as what we have seen happen in environmental, social, and governance (ESG) investing. There will be more transparency, which will be needed for investors to analyze the flood of product that will be in the field."

The success or failure of impact investing depends on the segments of investors who start from different places and pursue different strategies because of the way they are oriented and trained.

2 THE FUTURE OF IMPACT INVESTING

The growing, global cadre of leaders who are committing themselves and their institutions to this new style of investing have one belief in common: they insist that some level of financial return and social/environmental impact can be achieved together. Beneath this shared conviction, however, many differences must be confronted.

We dealt with these differences in our research by experimenting with many kinds of segmentation, testing alternatives in conversations with investors. The most promising approach, we believe, looks at how investors start from different places and pursue different strategies because of the way they are oriented and trained.

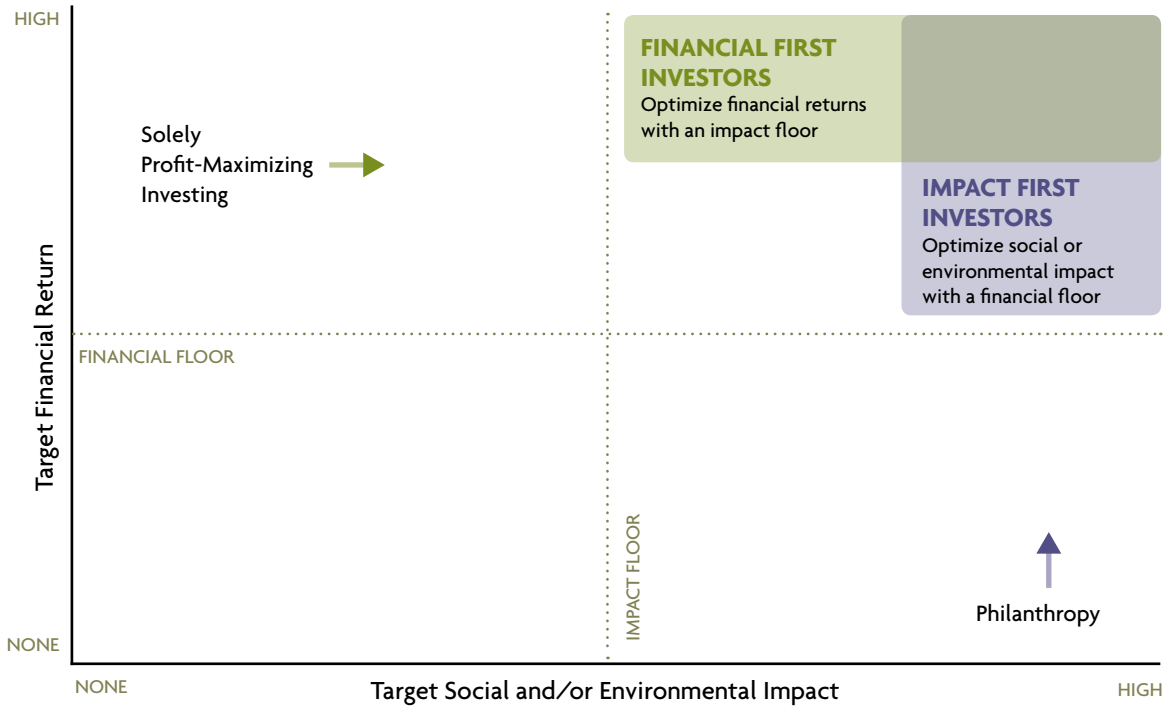
Impact investors can therefore be broadly classified into two groups based on their primary objective:

- **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.).

We chose to segment the emerging industry in this way because ultimately motivation determines the types of investments any particular actor will consider, regardless of the sector or geography in which they invest. Although investors who are solely maximizing profit can unintentionally make an impact investment (because what maximizes profit sometimes also happens to yield impact), only investors interested in some impact will be motivated to actively seek out these opportunities and place their capital. Moreover, in theory at least, a motivation

Impact investors can be classified into two groups based on their primary objective: Impact first investors, who seek to optimize social or environmental returns with a financial floor and financial first investors, who seek to optimize financial returns with a floor for social or environmental impact.

Segments of Impact Investors



toward impact should make a set of activities more likely to actually result in the impact aspired to—or to raise questions if it does not.

No segmentation can capture the dynamism of a marketplace perfectly, of course. But we have tested this one and found it helpful to many people, with the following three caveats:

- Some investors may have wide-ranging portfolios that touch on different approaches in different investments. In other words, the same investor may have deals that fall into different segments, based on their primary motivation for that particular deal.
- The size and importance of the segments will differ depending on the sectors and geography involved.
- Many investors in both segments aspire to maximize both objectives depicted in the area where these two segments overlap in the uppermost right-hand corner of the graph above. (Although it is not clear today exactly how many of these "have-your-cake-and-eat-it-too" deals exist, one of the best ways to test how many can be created is to try the recommendations suggested in this report.)

We chose to segment the emerging industry in this way because ultimately motivation determines the types of investments any particular actor will consider, regardless of the sector or geography in which they invest.

Once the industry is segmented in this way, it becomes possible to see an intriguing—and very promising—possibility with which many pioneers are already experimenting. Sometimes the two types of 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** (see the "Ex-

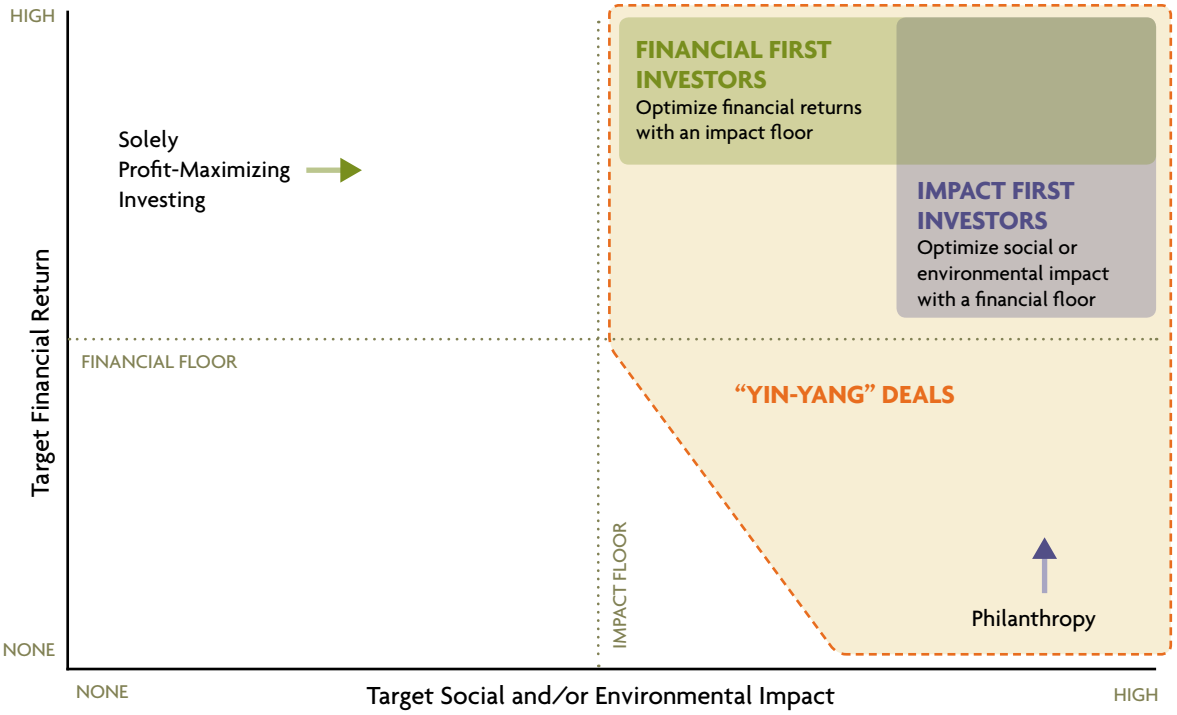
amples of Yin-Yang Deals" table on the following page for a few sample cases). This name is derived from the term in Chinese philosophy describing two elements that are different and yet complementary when put together.

Yin-yang deal structures can enable deals that could not happen without the blending of types of capital with different requirements and motivations. It can also enable the deals that any individual segment would pursue alone to be much more successful. Much more capital can flow to deals that otherwise only impact first investors would pursue. And much more impact can occur through deals that financial first investors would pursue but where they might not be willing to invest more to ensure the impact.

Today, organizing these types of deals efficiently is difficult, requiring unfamiliar institutions and individuals to work together by overcoming the distrust typically felt between, for example, private foundations and investment bankers. In the future, this yin-yang approach could develop—out of necessity and synergy—with a blending of the two types of capital and philanthropy through seamless networks into sophisticated investment structures that create the highest leverage of social and financial return. Increasing the scale and regularity with which these deals occur will require mechanisms for capturing learning and institutionalizing relationships, so that the effort put into creating one syndicate or deal structure can enable the next one, five, or 10 similar deals to be executed more seamlessly. More yin-yang deals may result from the successful development of impact and financial first investor markets.

Sometimes these two types of investors work together in yin-yang deals that combine capital from impact first and financial first investors, occasionally adding in philanthropy as well.

Segments of Impact Investors



Examples of Yin-Yang Deals

	AFFORDABLE HOUSING IN NEW YORK CITY	MICROFINANCE IN INDIA	JOB CREATION THROUGH MEDIUM-SCALE ENTERPRISE DEVELOPMENT
Objective	• Develop affordable housing leveraging a diverse set of investors in the NYC Acquisition Fund	• Support a microfinance institution that lends to small agricultural farmers and can provide a 5% first loss default guarantee for a loan	• Provide expansion capital to medium-scale businesses with the potential to scale and generate substantial job creation and supply-chain income improvements
Role of the *Impact First* Investor	• Fund guarantee pool from the City of New York ($8MM) and a set of nine foundations ($32MM)	• Second loss guarantee provided by Institute for Financial Management and Research Trust for 45% of loan amount ($2.6MM)	• Small Enterprise Assistance Funds (a global venture capital investment firm operating in emerging markets) sets up India Growth Fund in partnership with an Indian commercial bank • Small Industries Development Bank of India and United States Agency for International Development serve as anchor investors for the $160MM fund
Role of the *Financial First* Investor	• Senior lender debt from a syndicate of banks led by JPMorgan Chase ($195MM)	• Loan provided by mainstream bank's commercial division at a more favorable rate due to second loss guarantee ($5.75MM at 1.5% below the government of India's rate)	• Kotak Mahindra Bank (an Indian commercial bank) partners to create and invest in the fund

Increasing the scale and regularity with which these yin-yang deals occur will require mechanisms for capturing learning and institutionalizing relationships, so that the effort can enable the next deals to be executed more seamlessly.

Although each of these three segments—impact first, financial first, and yin-yang—has inherent risks and limitations, each can grow and succeed at scale over the next decade. In the challenging economic climate post the 2008 market meltdown, impact first investors may be most likely to stay committed to this type of investing and seize the existing opportunities. Mobilizing the substantial capital of financial first investors will require developing deal structures that give those investors confidence in the likely financial return. But over time **any combination of these segments could lead to the fulfillment of the promise of impact investing**.

Another possibility, of course, is that none of these three paths succeed, and the combination of risk factors swamps progress. It is actually a lot easier to see the many ways that impact investing fails to take off than it is to see how it ultimately succeeds, given the many challenges we have outlined.

What follows is a quick look at some of the paths that could lead to failure, and a longer look at the potential paths to success.

Think of what follows as learning from the future—taking a look ahead at what failure and success could look like over the next decade, so that we can come back to today smarter and more able to take the actions that will make the most difference.

How Impact Investing Could FAIL

Failure that could slow the momentum of this emerging industry could come from many directions—driven by the actions of practitioners within the field or by external factors. We know that the future scale and value of impact investing will be threatened if any of the following risks materializes:

- The risk that the industry becomes **collateral damage** in the global economic slowdown that took hold during 2008. This crisis could be long and deep, and/or lead to dramatic changes in industry structure and regulation that constrain investors' appetite for the new style of investing. There is a version of this downside view that simply delays the emergence of the industry until the next economic cycle. There is also a trajectory of the financial industry problems in which all the bets on when this type of investing could emerge are called off. (At the same time, if the worst happens, much else will change as well, including regulatory changes that could actually fuel investing for social and environmental impact.)
- The risk that investing for impact will ultimately be **too hard**. Current challenges could become persistent obstacles and insufficient compensation for risk may result in lack of interest in impact investing. The will to overcome the typical challenges facing a messy, new industry could disappear if investors simply give up too soon.
- The risk that investing for impact will ultimately be **too easy**. Here, the definition of social and environmental impact would turn out to be so loose and diluted as to be virtually meaningless. At best, this outcome would turn this type of investing into a "feel good" rather than a "do good" exercise. At worst, it would actually divert capital away from philanthropy, decreasing the amount of resource dedicated to confronting serious societal challenges. The hype about using markets to do good may create a bubble—especially if there is a significant gap between expectations for financial and social returns and actual performance, which may happen if the concept is sold ahead of demonstrated social impact and/or economically viable deal flow. Poor thinking and sloppy execution might lead to returns that are substantially below expectations.

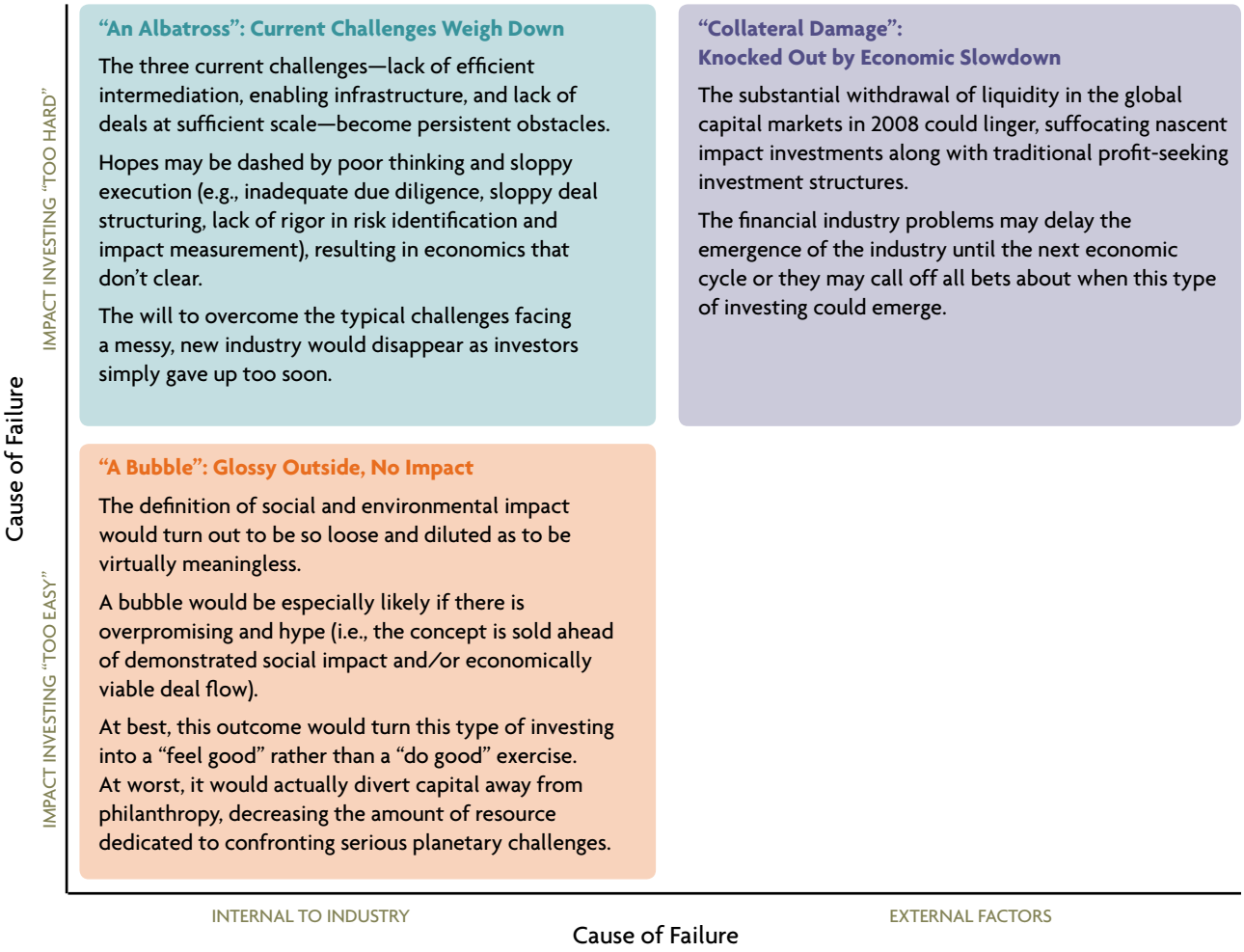
It's worth dwelling on this last point about impact. Although there is reason to be optimistic that lots of capital may call itself impact investing capital, there is also reason to be skeptical about how much of it will actually produce positive social and environmental change. The existing financial markets and incentives create a major pull toward "greenwashing" and dilution of standards—for example, as asset

Although there is reason to be optimistic that lots of capital may call itself impact investing capital, there is also reason to be skeptical about how much of it will actually produce positive social and environmental change.

managers seek to respond to growing client interest in impact investing without wanting to take on the long and difficult work of ensuring investment impact. And a few well-publicized losses due to these factors or outright fraud could lead to a backlash among investors. This serious risk threatens to undermine the very premise of these kinds of investments—a discomfort that can only be addressed by developing clear metrics that create greater transparency around impact.

There are clear risks that investing for impact may prove too hard or too easy. Early failures may be used as reasons—or excuses—to maintain the status quo. Yet many of these risks can be mitigated and the challenges overcome. Just as there are multiple ways to fail, there are many ways to succeed, too. Next we look at three complementary paths to success. Cluster of actors are already hard at work on strategies to address the opportunities and challenges.

How Impact Investing Could Fail



How Impact Investing Could SUCCEED

Over time, any combination of the three segments of investors—impact first, financial first, or yin-yang—could fulfill the promise of impact investing.

Impact First Investors Succeed

WHAT THIS FUTURE LOOKS LIKE	• **Impact-driven investors—including retail, high-net-worth individuals, corporations, and foundations—effectively develop skills and approaches that enable them to leverage investment as a tool to drive social change.** Impact investing outstrips philanthropy in terms of capital volume and, some would argue, impact. A range of supporting infrastructure—including intermediaries and social metrics—enables investors to better understand choices and tradeoffs.
HOW THIS FUTURE UNFOLDS	• Investors led by a **desire for social or environmental impact** use the market as a means to achieve it. • A crop of **high-net-worth individuals** decide that impact investing is a better use of capital than pure philanthropy (it may be more sustainable) or commercial investment (it may create more total value), even if sometimes the financial returns may be submarket. These investors **don't require market-rate returns** if their **capital is catalyzing impact**, especially in sectors where markets aren't fully developed (e.g., the firm responsAbility). • Impact investment becomes a popular **retail consumption experience** tied to brand and social networking (e.g., Kiva, MicroPlace). • Some **private banks** and **wealth advisors** are drawn in to offer innovative products for their clients (e.g., Calvert Community Investment Notes that clear through conventional channels and can be held in brokerage accounts). • **Foundations** increase the use of program-related investments and mission-related investments to achieve their missions. For example, U.S. foundations seek to leverage the assets that sit in their endowment (beyond the five percent required to be paid out annually). • **Multi-national companies or large national companies** (e.g., in China, Korea, and India) set aside concessionary capital to fund **socially oriented R&D and business development**. They may do this for a range of reasons, e.g., to ensure a secure supply chain or as a result of shareholder pressure. • **Sovereign wealth funds**, under public scrutiny to produce social as well as financial value, deploy substantial capital into impact investments. • "**Blended value**" and "**patient capital**" approaches to investing gain traction. This may occur as a result of a growing conviction that financially driven deals often sacrifice social impact and/or as a result of **moral objections to exploiting social problems for profit**.
CRITICAL SUCCESS FACTORS	• **Better metrics** are developed so investors know what they are paying for and validate that they are achieving their social or environmental objectives. • **More product innovation** becomes available to enable greater levels of investments and accommodate diverse social or environmental objectives. • **Infrastructure specially suited to these opportunities** is developed (e.g., a separate social stock exchange). • **Existing market infrastructure** is harnessed as a channel. • **A Capital Asset Pricing Model is developed** for submarket rate investments, making it easier to underwrite deals.
INHERENT LIMITATIONS	• The size of the market is likely to remain **relatively small** compared to the overall capital markets.
RISKS	• Investors **can't articulate** the **value gained in social return relative to the potential sacrifice of financial return.** • **Impact investing becomes too "precious"**—social enterprise becomes an insular, fragmented niche that shelters enterprises from tapping commercial markets and scaling. • **No consensus is reached on metrics** and too much time is spent developing competing and elaborate evaluation methodologies that don't yield much. • **Impact first investing cannibalizes traditional philanthropy**, especially in financial downturns.

Financial First Investors Succeed

WHAT THIS FUTURE LOOKS LIKE	• **Commercial investors with social objectives find attractive financial opportunities while having a positive impact, often by integrating social and/or environmental considerations into investment decisions.** Financially motivated investors aggressively hire nontraditional talent to gain specialized skills to identify and exploit opportunities.
HOW THIS FUTURE UNFOLDS	• **Social and environmental considerations become seen as components of financial valuation.** The old conventional wisdom about tradeoffs between impact and financial returns turns out to be false, at least in important cases. • **The challenge of achieving impact without relaxing financial goals creates discipline that increases the productivity and creativity** of investments. • Some leading investors engage in impact investing but **are not willing to make a financial sacrifice**. This may include institutional investors, especially pension funds, seeking to satisfy stakeholders. It may also include corporations looking to the large market of poor people (commonly called the "bottom of the pyramid") for growth. • Early returns in clean tech and microfinance spur a **"gold rush" that catalyzes the development of intermediaries** that begin sourcing broader impact investment opportunities. • New **policies** create incentives to move capital into impact investments. • Investors become open to **returns achieved over longer time horizons**.
CRITICAL SUCCESS FACTORS	• **A viable market of investment opportunities** is developed with risk-adjusted rate of return at sufficient scale. • **Social and environmental considerations are incorporated** into research and valuation. • **Competitive returns are demonstrated** because of the incorporation of social and environmental considerations. • **Large lead investors help develop and shape the market** by identifying top managers and deals that others can pile onto. • **Impact ratings systems** enable investors to **assess the social/environmental impact** of projects easily without expensive due diligence. There is an **accepted set of minimum standards** to certify companies and-deals, providing legitimacy and verification that commercial opportunities are at least not destructive (e.g., branded certification like fair trade).
INHERENT LIMITATIONS	• The ability to achieve risk-adjusted financial returns and some social or environmental impact will only hold true for **certain types of investment opportunities** (whether private or public) at certain stages of their development. Some social and environmental issues are unlikely to generate commercial returns in the short term or ever.
RISKS	• Creating meaningful impact while pursuing risk-adjusted return turns out to be **too difficult** to assess or impossible to achieve given the focus on financial return. Potentially the assumption that some social/environmental factors are critical drivers of financial value doesn't hold in many cases. • **The bursting of a financial bubble** in a sector related to impact investing causes investors to flee and raises skepticism of the approach (i.e., it becomes a fad like clean technology in the 1980s). • A massive number of **"easier" deals** in sectors like clean tech and microfinance **cause other impact investing sectors to flounder**. • Vocal **critics of the approach** and/or a low level of social/environmental impact damage investors' reputations and discourage further investment. • A **mismatch of expectations** among investors in long-term projects leads to investors pressuring for premature exits, depressing returns and damaging the field's reputation. • An "**integrity constraint**" emerges as commercial capital invests in projects that misrepresent themselves as having a positive impact or have unintended consequences that result in the impact being much lower than believed—or even net negative. Some believe this is already occurring, e.g., with predatory lending practices in microfinance institutions or with profit-chasing biofuel investors who may be destroying habitat and creating higher food prices for the poor. • This segment could **dry up capital** in all the other paths.

Building a marketplace designed for each of the impact first and financial first segments individually will undoubtedly help accelerate the industry. But on their own, these two types of investing may not be enough.

Investors from both segments agree on the potential of a deal space where they come together, sometimes with philanthropy also subsidizing key aspects of the whole value chain (which is how microfinance has grown over its nearly four decades). As David Blood, senior partner at Generation Investment Management, states: "The most interesting opportunity—in addition to developing intermediation—is taking different groups of investors and finding ways to make them work together and at the same time leveraging their respective return expectations."

Investors Mix Together: Yin-Yang Deals

WHAT THIS FUTURE LOOKS LIKE	• **Pragmatic attitudes, increasingly flexible deal structures, and smarter help from existing and new intermediaries enable impact first and financial first investors—as well as donors—to play in the same sandbox.** Commercial and social actors co-invest in deals in ways that meet their respective (and sometimes divergent) interests and enable deals that wouldn't have happened at similar scale in the absence of collaboration. Social actors become adept at using markets and market players to help achieve mission ends and collections of odd bedfellows in transactions become commonplace.
HOW THIS FUTURE UNFOLDS	• Investors move to this integrated space because it **enables them to do deals that they otherwise couldn't do**. Financial first investors can leverage sub-market-rate capital to make projects viable that they couldn't otherwise do at a market rate—their investments are being "de-risked" by impact first investors. Impact first investors see their investments leveraged substantially, enabling them to address some issues that could not be addressed at scale without inclusion of commercial investors. • Some actors may be **dedicated to yin-yang**, others may focus on other paths but **participate in specific yin-yang investments** as they advance their social and financial objectives. • New or existing intermediaries **develop capabilities to structure deals** and package different types of capital.
CRITICAL SUCCESS FACTORS	• **The ability grows to structure deals without prohibitive transaction costs and to institutionalize the learning from innovative deals** to reduce transaction costs when they are replicated. **Creative packaging instruments** make it possible to **segment returns within a given deal or fund**. • A **network/community is developed to enable linkages between investors** with different financial and impact return profiles. • **Sufficient submarket and/or grant capital** exists to be bundled with commercial capital, whether from private or public sources. Concessionary capital providers are not worried about subsidizing the returns of commercial investors or feeling angst about "selling out" or "greenwashing." For example, although foundations are prohibited from supplementing the financial returns of other investors, they will invest in the same project at a different interest rate, focusing on the benefit to the fund/project/organization so that the blended rate is more affordable. • **Commercial capital is not hesitant to participate in joint deals**, e.g., due to skepticism about bureaucracy/different incentives of concessionary capital providers like development finance institutions. • Common approaches are developed for **assessing social/environmental elements** of investments.
INHERENT LIMITATIONS	• Yin-yang is **unlikely to grow to be as large as the financial first market**, although it could be much larger than the impact first segment. • Some deals may always be **more difficult and expensive to structure**, especially relative to deals where market rate return can achieve similar impact objectives while engaging fewer/more similar types of investors. • **Boutiques of specialized intermediaries may be needed** if experience isn't scalable or feasible across sectors and geographies.
RISKS	• **A yin-yang segment may be inherently unstable because the other evolutionary paths** put pressure on it—so it may be a place people visit but don't remain. For example, investors may move back to pure financial first deals if financial returns in yin-yang deals are not clear. Alternatively, if talent wars develop, top-notch people may leave the yin-yang space to pursue more purely commercial opportunities. Or investors may be pulled back to pure impact first deals if they encounter dire financial straits and the cost of capital increases—or if they become concerned about subsidizing returns of more commercially minded investors. • In addition, the credit crisis of 2008 could create **wariness about mixing different levels of risk and placing capital in highly structured financial products**.

PROFILE: **TIAA-CREF**

U.S. Pension Fund Pursues Global Social and Community Investment Programs

SNAPSHOT

HOW IT BEGAN: Building on a history of social investing stretching back to the anti-apartheid period, TIAA-CREF significantly increased its emphasis on socially responsible investing with the formation of a new global social and community investing department in 2006. Much of the impetus for forming the department came from an extensive survey of its investors in 2005, which confirmed a high level of interest in all three major socially responsible investing strategies. The company manages retirement assets for over 3.4 million investors working at over 15,000 not-for-profit academic, cultural, medical, and research institutions.

SECTORS: Real estate (geared toward affordable housing and sustainable development), domestic community banking, and global microfinance

GEOGRAPHIC FOCUS: Global

BASED IN: U.S.

YEAR: Corporate social real estate (1992), microfinance (2006), community banking deposits (2007)

SIZE OF FUND: Approximately $250 million investment with commitments of approximately $600 million (to be deployed), all within a larger fund

INVESTMENT THESIS: Require competitive risk-adjusted returns, seek some reasonable indication of positive impact, and invest in areas likely to have broad social appeal.

PERSPECTIVE

From Scott Budde, managing director, Global Social & Community Investing, TIAA-CREF

INVESTOR INTEREST: "There has been underlying demand for quite a long time. TIAA-CREF began early examples of shareholder activism in the 1970s and one of the first major socially screened funds in 1990. We recently shifted to being more proactive to meeting this demand and developed it into a core competency for our organization and a competitive advantage in the marketplace."

INVESTMENT OPPORTUNITIES: "We have found the investment opportunities to be much stronger than we expected. Our microfinance investments have performed very well and we have seen many interesting models in the real estate and domestic community banking market."

POTENTIAL FOR LEADERSHIP: "By being focused and developing our expertise we think we can be both more effective investors and draw more capital into these areas."

CHALLENGES:

"It is difficult to design products and communication strategies around them. You get into the myths in the space, such as the belief that you must give up returns to have impact, which has not been our experience."

"We have selected our programs based both on the above criteria and on the availability of viable investment opportunities. There are a lot of areas that we can't invest in because there is a lack of opportunities at scale."

"We're not engaged in any below-market rate financing. I find many of these options to be confusing and possibly counter-productive. For a mainstream institutional investor like TIAA-CREF it is much more efficient to stick with market-rate alternatives that can catalyze large flows of investment funds."

IF IMPACT INVESTING WERE A MATURE INDUSTRY . . . "There would be a broader selection of high-quality investment opportunities and it would be easier to access them through a wider array of investment products. With greater scale the transaction costs would go down, making impact investing more accessible to a broader range of investors."

PROFILE: **AQUIFER**

Fund Pioneers the Development of Sustainable Businesses in Mozambique

SNAPSHOT

ORIGIN: Lord Sainsbury of Turville has been involved in development efforts in sub-Saharan Africa over the past 30 years. His extensive experience in the region gave him an understanding for the need to stimulate private investment for sustainable development; he founded Aquifer to invest in sustainable models of enterprise, drawing upon the expertise of his family office. After surveying potential countries to focus on, Aquifer settled on Mozambique because of the opportunity for impact: Mozambique has a receptive political environment and a need for investment capital stemming from a risk aversion in its capital markets and the lingering effects of its civil war on its economic development. Aquifer has invested in two industrial companies so far and it takes an active management role in their development.

SECTOR: Sustainable agriculture

GEOGRAPHIC FOCUS: Mozambique

BASED IN: U.K.

YEAR: 2005

SIZE OF FUND: $50 million has been deployed out of a $100 million fund

INVESTMENT THESIS: Aquifer aims to demonstrate the viability of a model of sustainable business that makes ownership more widely available to employees and to an emerging capital market in Mozambique. Aquifer's goal is to develop these businesses so they can earn market rates of return, but it is willing to take a sub-market return if necessary to get them off the ground. Aquifer only takes equity stakes in its companies to shelter them from debt.

PERSPECTIVE

From Chris Foy, chief executive of Aquifer and group director of the Family Office of Lord Sainsbury

EMERGING OPPORTUNITIES: "Our first two investments have given us experience that will enhance our ability to make future investments. We have developed a strong understanding of the local markets, operational dynamics, and technology. This allows us to see opportunities for other business models as well as parallel investment opportunities, like water and energy infrastructure."

POTENTIAL FOR LEADERSHIP: "Impact investors need a collective, legitimate voice to advocate for this type of investing and recruit other investors to orient themselves toward impact. It is also important to have pathfinders who demonstrate the viability of this approach so other investors understand its potential."

NEED FOR TECHNICAL ASSISTANCE: "There is a great need for quality technical assistance. We have recruited experienced financial managers to support management teams in Mozambique on a secondment basis. They act as coaches and specialized resources for the companies."

TIME HORIZON: "Fund managers are so focused on moving rapidly toward an exit opportunity. We are taking a more patient approach to investing because it is needed to develop more sustainable businesses, which ultimately result in greater impact and stronger performance."

CHALLENGES:

"Finding strong entrepreneurs and managers has been a challenge. It is especially difficult to find managers who are skilled in the finance functions like business planning and accounting. We invest a lot in recruiting, both domestically and internationally."

"It isn't easy to start this work from scratch—if you want to be successful in this type of investing you have to get your hands dirty. It helps to have a network of peers sharing experiences and supporting one another."

IF IMPACT INVESTING WERE A MATURE INDUSTRY . . . "There would be an ecosystem of service providers to support impact investing, and there would be a collective voice recruiting additional investors to the space and connecting them to one another."

Increasing the scale and impact of this type of investing will require action to unlock a latent supply of capital by developing enabling infrastructure and efficient intermediation.

3 AN APPROACH FOR ACCELERATING PROGRESS

There is no substitute for the hard work of making investments and doing what it takes to ensure that they succeed. Without that, nothing else matters. But the emerging impact investing industry could remain stuck for a long time in the first phase of its evolution—uncoordinated innovation—unless concrete actions are taken to build a more coherent marketplace. That's the only way to remove barriers and mitigate risks across the futures we have described, both for individual segments and for the industry as a whole.

What concrete actions are needed? There is a classic chicken-and-egg problem of balancing the tension between pumping up supply versus pumping up demand. Although we believe an initial focus on improved intermediation will be important, ultimately both improved supply and demand will be required. Investors, entrepreneurs, and philanthropists all have an important part to play in providing the leadership, capital, and collaboration necessary for success in this next phase.

Investors, entrepreneurs, and philanthropists all have an important part to play in providing the leadership, capital, and collaboration necessary for success in this next phase.

Three Platforms for Marketplace Building

Increasing the amount of money and the social and environmental value of impact investing will require unlocking capital by developing intermediation and **by developing infrastructure to facilitate deals**. These actions will be as essential to securing the promise of this industry as they were for venture capital. As Sir Ronald Cohen, a venture capital pioneer in the U.K., notes, "It is true in the case of social investment as it has proved to be in that of venture capital and private equity that the supply of money creates its own demand and an increased flow of capital is therefore the starting point."[26]

Still, this simple parallel, while persuasive, is insufficient when it comes to the challenges facing entrepreneurs building businesses for impact, especially in developing countries. It takes time to develop proven, large, investable opportunities. **So action will also be required to address the imminent barrier of insufficient absorptive capacity for investment capital by supporting the development of scalable, backable business models**.

Action will also be required to address the imminent barrier of insufficient absorptive capacity for investment capital by supporting the development of scalable, backable business models.

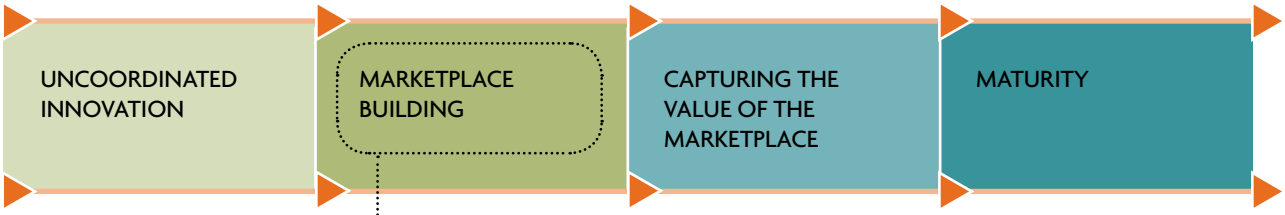
We have identified a diverse and interrelated set of initiatives, all of which are within the marketplace-building stage of industry development. They are grouped into three platforms based on the challenges constraining impact investing:

- *Unlock Latent Supply of Capital by Building Efficient Intermediation*—Enable more investing for impact by building the investment banks, clubs, funds, and products needed to facilitate existing interest.
- *Build Enabling Infrastructure for the Industry*—Build the ecosystem for impact investing, including common metrics, language, and an impact investing network that can serve as a platform for collective action such as lobbying for policy change.
- *Develop the Absorptive Capacity for Investment Capital*—Develop investment opportunities and ensure high-quality deal flow by cultivating talented entrepreneurs and supporting the enabling environment for private sector innovation and success in regions and sectors where investment can create impact.

These three platforms address the challenges of all the investor segments we identified (financial first, impact first, and yin-yang), which all need proactive intervention to create the conditions that will lead to success and minimize the significant risks.

However, specific investor segments will need the platforms in different ways. And sometimes the investors most likely to benefit from related initiatives are not necessarily the most likely to pursue or fund them.

Three Platforms to Build a Marketplace for Impact Investing



Challenge:	LACK OF EFFICIENT INTERMEDIATION	LACK OF ENABLING INFRASTRUCTURE	LACK OF SUFFICIENT ABSORPTIVE CAPACITY
Platform:	Unlock Latent Supply of Capital By Building Efficient INTERMEDIATION	Build Enabling INFRASTRUCTURE for the Industry	Develop the ABSORPTIVE CAPACITY for Investment Capital
Investor Segments for Whom Challenge Is Greatest:	**Impact first and yin-yang investors**, since traditional channels do not meet their needs	**All segments of investors** will find most of these initiatives important	**Financial first investors** will tend to be the first to experience the lack of a sufficient number of deals yielding attractive returns as a critical binding constraint
Investor Segments Most Likely to Pursue / Fund Initiatives:	**Impact first and yin-yang investors**, new entrepreneurs, or existing intermediaries	**Industry actors interested in developing public goods** will be most likely to pursue or fund these initiatives since they tend to require greater levels of capitalization and coordination	**Impact first investors** may be more likely to pursue these initiatives and help bring business models to a commercially viable stage

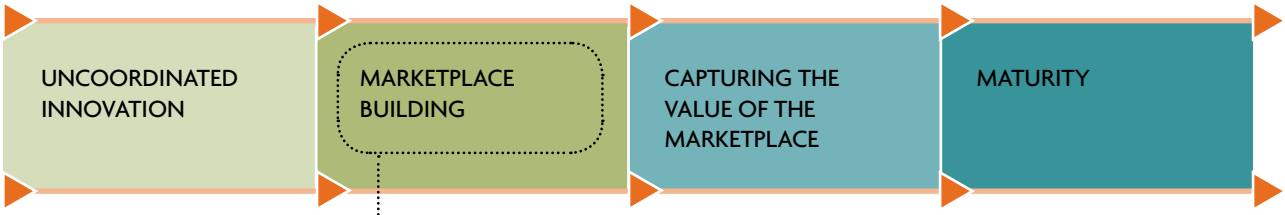
Key Initiatives within the Platforms

Our research revealed that the following key initiatives will be important to advancing the three platforms that can build the marketplace for impact investing. Detailed descriptions can be found in the "Blueprint for Breakthrough" later in this document.

The form an initiative takes may depend on the investor segment for which it is designed. For example, the effort may differ if optimized for impact first investors as opposed to financial first investors or for a yin-yang world. So for action to be meaningful, we need to distinguish ever more carefully between different types of investing for impact.

For many of these initiatives there are at least nascent efforts under way in some part of the world. Where appropriate, additional work could be built upon these initial efforts or modeled on similar work in other contexts. The final section with the detailed blueprint includes some examples of where these activities are already getting traction and analogous activities that have helped other industries develop.

Key Initiatives to Build a Marketplace for Impact Investing



Challenge:	LACK OF EFFICIENT INTERMEDIATION	LACK OF ENABLING INFRASTRUCTURE	LACK OF SUFFICIENT ABSORPTIVE CAPACITY
Platform:	Unlock Latent Supply of Capital By Building Efficient INTERMEDIATION	Build Enabling INFRASTRUCTURE for the Industry	Develop the ABSORPTIVE CAPACITY for Investment Capital
Initiatives:	**A.** Create industry-defining funds that can serve as beacons for how to address social or environmental issues **B.** Place substantial, risk-taking capital into catalytic finance structures **C.** Launch and grow dedicated impact investment banking capabilities **D.** "Pull" existing intermediaries into impact investing by making business commitments **E.** Create investment clubs focused on specific themes **F.** Support the development of backable fund managers **G.** Create financial products to increase accessibility	**H.** Set industry standards for social measurement **I.** Lobby for specific policy/regulatory change **J.** Develop an impact investing network to accelerate the industry **K.** Develop risk assessment tools **L.** Coordinate development of a common language platform **M.** Create publicly available comprehensive benchmarking data **N.** Integrate social and environmental factors into economic and finance theory **O.** Launch a targeted public relations campaign to promote demonstrated successes	**P.** Support effective and scalable management capacity development approaches for entrepreneurs **Q.** Provide tools to support research and development for innovative, scalable models

Combining Priority Initiatives to Catalyze Progress

Of the many important initiatives, we highlight the five that we believe together have the greatest potential to catalyze the industry's development:

Five Priority Initiatives

The five priority initiatives to catalyze impact investing are:

- Create industry-defining funds that can serve as beacons for how to address specific social or environmental issues
- Place substantial, risk-taking capital into catalytic finance structures
- Set industry standards for social measurement
- Lobby for specific policy/regulatory change
- Develop an impact investing network

UNLOCK LATENT SUPPLY OF CAPITAL BY BUILDING INTERMEDIATION

- **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 serve as beacons and attract a wave of additional investors and ideas, much as the Apple initial public offering catalyzed the venture capital industry. At the same time, these funds could stimulate the market's development by attracting talented entrepreneurs to launch businesses and intermediaries while consolidating capital and reducing transaction costs associated with fragmented supply. The funds could also create platforms to seed and build the capacity of new fund managers and to roll out impact metrics or standards in ways that reinforce the funds' financial objectives.
    - *For example:* A collection of investors commit $1 billion to an impact investing fund, which attracts fund managers, service providers, and entrepreneurs to the field. This could kick off a virtuous cycle as it becomes easier for additional investors to engage in impact investing, which in turn attracts more entrepreneurs and creates more business for intermediaries.
- **Place substantial, risk-taking capital into 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; without commercial investors, it may be more challenging to invest the volume of funds required to make a difference. As David Zellner of the Chicago-based General Board of Pensions and Health Benefits explains, "The General Board will only lend funds for social impact investments at market rates. We are often presented with investment opportunities that require below-market funds for them to be viable. However, many projects are unable to secure soft money commitments. Hence, we are unable to participate in these types of projects." Unfortunately, these unusual mezzanine 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 investors are most likely to act if it will ultimately produce substantive social or environmental benefits.
    - *For example:* Create a concessionary capital fund that can nimbly match its funds with more commercially oriented capital. The fund might focus on providing secondary financing to allow primary investors to exit while leveraging their expertise in deal sourcing.

BUILD ENABLING INFRASTRUCTURE FOR THE INDUSTRY

- 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. As a portfolio manager at a major U.S. pension fund explains: "Measurement of 'ancillary' benefits is going to be an ongoing issue in impact investment. The industry needs to capture and demonstrate these benefits in order to attract more capital."
    - *For example:* Two sets of initiatives would help achieve this goal: developing rigorous metrics and a standard-setting body to implement them. For impact first investors, the most important priority is to develop rigorous metrics for assessing the relative social and environmental impact of investments and portfolios within and across the sectors and geographies that matter to them. This would allow them to assess the results from investments that may be below market rate. Understanding this potential tradeoff will be especially important to institutional investors. An additional step would be to establish a standard-setting body that would help create a threshold for what would be considered an impact investment. A basic rating system would help organize the market by making it possible to compare outcomes of investments. It would also help protect the credibility and reputation of the field from conventional investments being promoted as impact investments. There is much to be learned from the standards-setting activities in socially responsible investing, including the framework of the Global Reporting Initiative and the Ceres Principles.
- 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. As Kyle Johnson, an investment advisor at Boston-based Cambridge Associates, describes, "I cannot underline how important the policy piece is in driving change. . . . When market behaviors are not aligned with positive social and environmental outcomes, a key question to ask is 'Why?' If the answer is that there is some form of coercion present in the market, such as the externalization of social or environmental costs, then working to change public policies to help realign market incentive structures is a really important approach to consider." 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.
    - *For example:* Policy mechanisms could include anything from a reduced capital gains tax on impact investing products to scrutiny and clarifica-

For many of these initiatives there are at least nascent efforts under way in some part of the world. Where appropriate, additional work could be built upon efforts already under way or modeled on similar work in other contexts.

Substantive change often begins in a crisis, and the financial crisis that took hold in 2008 may create just such an historic opportunity.

tion of the meaning of "fiduciary duty" or the development of a fund to catalyze impact investments similar to the Community Reinvestment Act, but for a broader set of social and environmental issues. Governments could also leverage their role as large-scale purchasers by providing anchor demand for promising enterprises, enabling them to prove and scale their business models.

- 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. The network can enable impact investors to share experiences, pursue investment opportunities, and forge partnerships, and can serve as a source of information for organizations committed to field building. The network would be particularly valuable for deals that mix impact first and financial first investors.
    - *For example:* Investors build a global network for the impact investing field that serves as a hub for collaboration and a platform for setting clear definitions and standards. Investors develop relationships for sharing information, co-investing, and engaging in new projects. The network also provides the community with a common voice in policy advocacy efforts.

Depending on the specific geography and sector, success will require some combination of these five high-priority initiatives and the 12 additional initiatives detailed in the "Blueprint for Breakthrough" at the end of this document—and undoubtedly others as well. Some actions will come to fruition quickly and help alleviate constraints in the marketplace, while others will lay the groundwork for the future structural shifts needed to broaden the market and transform the ecosystem to support a new kind of investing.

Together, these actions can help guard against the risk that investing for impact might become too easy—enabling rigor, discipline, and high standards by creating, for example, metrics that define what qualifies as impact investing. They can also help address the risk that this new style of investing stalls because it remains too hard—by building the necessary intermediation that can help avoid hype and sloppy execution.

What's Required for Success: Leadership, Coordination, and Capitalization

Taken together, these initiatives have the potential to help build the marketplace and ensure the promise of impact investing. But **the initiatives outlined will only become a reality if leaders—investors, entrepreneurs, and philanthropists—emerge to advance them**. As Chris Foy of Sainsbury Family Investments explains, "Impact investors need a collective, legitimate voice to advocate for this type of investing and recruit other investors to orient themselves toward impact. It is also important to have pathfinders who demonstrate the viability of this approach so other investors understand its potential."

Actions need to be taken to build the marketplace as a whole, seeing investing for impact as one industry with a common value chain and clear, shared challenges, regardless of geography or sector. At the same time, actions also need to focus on enabling the distinct segments of impact first, financial first, and yin-yang investors to develop successfully in their different regions and sectors.

Leaders who understand what is at stake will need to consider how others can leverage the time and effort they have put in. These pioneers will come from many places, do different things, and use different types of capital; they will include large-scale family offices, institutional investors, pension funds, investment banks, wealth managers, and private foundations. **These leaders have an opportunity to take a more active role in driving the evolution of investing for impact, as they can steer billions of dollars of capital, support collective action, command the authority to set standards, and back new businesses and funds that can fill in the gaps in the impact investing ecosystem.** And those who are just getting started will need to look to the leaders who have figured it out to see what can be learned from their experience so they don't reinvent the wheel.

These initiatives will also need to be well executed with a range of coordination and capitalization.

- Coordination—Many of the initiatives we outline will require a significant level of coordination or collaboration. Success will require a flexible philosophy because collaboration may require a bit of compromise. It will not be possible to build a market if everything investors want is idiosyncratic and they all insist on getting exactly what they want.
- Capitalization—Success will require people who will put their money into impact investments as well as people and institutions who will help capitalize the industry through intermediary and infrastructure development.

The table on page 51 ("Leadership Needed to Enact Initiatives") maps the initiatives based on the minimum amount of coordination and capitalization required for them to be effective broadly. In the lower left-hand corner are immediate entre-

These actions can help guard against the risk that investing for impact becomes too easy—enabling rigor, discipline, and high standards by creating, for example, metrics that define what qualifies as impact investing. They can also help address the risk that this new style of investing stalls because it remains too hard—by building the necessary intermediation that can help avoid hype and sloppy execution.

preneurial opportunities that require less coordination and can be funded through short-term profit or medium-term development funding. In the upper right-hand corner are initiatives that require both subsidy and industry level coordination—notably, this is where three of the five high priority initiatives fall. This mapping can help actors consider what action they want to lead or participate in. For example, philanthropy may have a particularly important role to play in the upper right-hand corner, building some of the infrastructure that will require a high degree of subsidy and coordination.

The industry will need stewards to marshal the collective action required to develop public goods infrastructure and to support those initiatives that may require coordination and at least an initial subsidy.

As this table indicates and the history of other industries teaches, **potential leaders will need to do more than just their day jobs in order to overcome current challenges and mitigate future risks**. Many entrepreneurial efforts operating in parallel, without some coordination, run the risk of re-creating the very problems of fragmentation, duplication, and underleverage that they are attempting to solve. Value could be left on the table, with a greater likelihood that the industry will succumb to the challenges and risks we have outlined.

Investors, entrepreneurs, and philanthropists therefore all have an important part to play in providing the leadership, capital, and collaboration needed to catalyze investing for impact. The industry will need stewards to marshal the collective action required to develop public goods infrastructure and to support those initiatives that may require coordination and at least an initial subsidy.

Leadership Needed to Enact Initiatives

What type of CAPITALIZATION is required?	Operating alone	Small groups of individuals or institutions	Industry level coordination
Subsidy (philanthropy, government, corporate social responsibility)	N. Integrate social and environmental factors into economic and finance theory P. Support effective and scalable management capacity development approaches for entrepreneurs	F. Support the development of backable fund managers	**H. Set industry standards for social measurement** **I. Lobby for specific policy/ regulatory change** **J. Develop an impact investing network** L. Coordinate development of a common language platform O. Launch a targeted public relations campaign to promote demonstrated successes
Medium-term development funding	C. Launch and grow dedicated impact investment banking capabilities K. Develop risk assessment tools	E. Create investment clubs focused on specific themes Q. Provide tools to support research and development for innovative, scalable models	M. Create publicly available comprehensive benchmarking data
Short-term profit	G. Create financial products to increase accessibility	**A. Create industry-defining funds that can serve as beacons for how to address social or environmental issues** **B. Place substantial, risk-taking capital into catalytic finance structures** D. "Pull" existing intermediaries into impact investing by making committments business	

What level of COORDINATION is required?

Note: Bold indicates a priority initiative.

PROFILE: GENERATION INVESTMENT MANAGEMENT'S CLIMATE SOLUTIONS STRATEGY

Fund Invests in Private Sector Responses to the Climate Crisis

SNAPSHOT

HOW IT BEGAN: Generation was co-founded in 2004 by former U.S. Vice President Al Gore and former head of Goldman Sachs asset management David Blood as an investment firm that integrates sustainability factors into its fundamental investment analysis. Its flagship strategy is Global Equity, which is focused on taking long-only positions in 30 to 50 public companies and has about $3 billion in assets under management. In 2007, Generation launched its second strategy: deploying capital to help solve the climate crisis through investments in private equity, restricted public equity, and unrestricted public equity. This strategy leverages the deal flow and expertise that Generation has built in its Global Equity experience.

SECTORS: Renewable energy generation and distribution; energy efficiency and demand destruction; carbon markets and climate-related financial services; solutions for the biomass economy

GEOGRAPHIC FOCUS: Global

LOCATION: U.K. and U.S.

YEAR: 2007

SIZE OF FUND: Climate Solutions Fund: $683 million

INVESTMENT THESIS: Generation's investment approach is based on the idea that sustainability factors—economic, environmental, social, and governance criteria—will drive a company's returns over the long term. By integrating sustainability issues with traditional analysis, Generation aims to deliver superior investment returns.

PERSPECTIVE

From David Blood, senior partner

A NEW INVESTMENT PHILOSOPHY: "We founded Generation in 2004 to develop a new philosophy of investment management and business more broadly. Our approach is based on the long term and on the explicit recognition that sustainability issues are central to business and should be incorporated in the analysis of business and management quality. Nearly five years on, our conviction on the importance of sustainability in delivering long-term performance has increased."

SETTING GOALS: "We'll know we're successful if the world is able to address the climate change concerns that exist today in the next 10 years. In addition to high-level goals like this, impact investing will also need proof statements at the micro-level, such as tracking the number of jobs created by the investments in a given portfolio."

POTENTIAL FOR A NETWORK: "There is a real need for a network to be created to serve two main functions. First, it needs to support the activities of the early movers and help develop a more sophisticated and fluid marketplace. Second, it needs to expand the market by attracting new impact investors into that marketplace."

NEED FOR INTERMEDIATION: "There is also a clear need for intermediation between social businesses and sources of capital. The market is still inefficient and it constrains the level of impact investing activity."

IMPORTANCE OF ENGAGING MAINSTREAM INVESTORS: "Pension funds and leaders from the financial world have to be early movers in impact investing to give it the credibility it needs."

A POTENTIAL TRANSITION POINT IN THE MARKETS: "What is clear to us and many others is that market capitalism has arrived at a critical juncture. Even beyond the bailouts and recent volatility, the challenges of the climate crisis, water scarcity, income disparity, extreme poverty, and disease must command our urgent attention. In fact, the financial crisis has reinforced our view that sustainable development will be the primary driver of economic and industrial change over the next 25 years."

CHALLENGES: "There is a significant gap between the capital needed and the capital currently deployed to create enduring solutions to the climate crisis. To address this financing gap will require the efforts of many players, including entrepreneurial ventures, multinational businesses, governments, multilaterals, and investors. Investing in scalable solutions now is critical for the future of the planet."

IF IMPACT INVESTING WERE A MATURE INDUSTRY . . . "We would have contributed to a more long-term and responsible form of capitalism—one with a more holistic investment perspective. Thinking 'sustainably' means embracing a systems view of the world—a perspective that focuses on inter-relationships. True sustainability means judging solutions on a life-cycle basis and considering the complete set of inputs, costs, and externalities of an investment."

PROFILE: **NEW YORK CITY ACQUISITION FUND**

Foundations and Commercial Banks Collaborate to Develop Affordable Housing

SNAPSHOT

HOW IT BEGAN: During the 1990s and early 2000s, New York City saw a steadily shrinking supply of housing and a corresponding increase in property values. By 2004 these factors resulted in the near exhaustion of the city's real estate stock for affordable housing development. Four foundations funded the development of a structure that combines program-related investments from a larger group of foundations and a loan from the city to create a guarantee pool, which leverages lending capital from commercial investors. The Fund is designed to enable affordable housing developers to access flexible capital on a timely basis in order to acquire properties opportunistically when they came on the market.

INVESTOR(S): A syndicate of 12 banks led by JPMorgan Chase ($160 million) provides the senior lender debt, the City of New York ($8 million), and a group of nine foundations ($32 million) provides a guarantee pool. Enterprise Community Investment Inc. and the National Equity Fund are the Fund's Members and Forsyth Street Advisors serves as the Fund Manager.

SECTOR: Affordable housing

GEOGRAPHIC FOCUS: U.S.

BASED IN: U.S.

YEAR: 2006

SIZE OF FUND: About $200 million

INVESTMENT THESIS: The Fund extends loans made by participating banks to enable affordable housing developers to acquire land and occupied buildings. Developers subsequently assemble the necessary resources to begin construction on vacant land or begin the rehabilitation process to preserve existing occupied affordable housing. The Fund's goal is to create as many as 30,000 units of affordable housing over a 10-year period, 10,000 of which should be preservation units and 3,000 of which should support home ownership.

PERSPECTIVE

From E. Tyler Van Gundy, associate, Forsyth Street Advisors

THE DEMONSTRATION EFFECT: "A successful program serves as a model for new funds in new markets. Variations of the Fund's structure have been established in Louisiana, Los Angeles, and Chicago involving several of the same foundation and bank investors."

THE LEARNING CURVE: "The research and development process in New York City was approximately 1.5 years—we were inventing the wheel. In Los Angeles it took half of the time to raise a $100 million lending facility with a $13.75 million guarantee pool. The startup costs were substantially lower. We had developed the approaches, our legal team was familiar with the structure and process, and we had gained a knowledge base from our New York experience."

OPPORTUNITIES: "We see other opportunities for public-private partnerships similar in structure to the Fund. For example, small-business lending or an energy efficiency building retrofit program may benefit from a similar public-private credit enhancement structure."

CHALLENGES:

"Both the New York and Los Angeles funds are extremely complex structures. Because of the multiple investors there is a coordination challenge. The closing process becomes streamlined once repeat investors establish their knowledge base."

"This structure works in large cities because they have the scale to make it work. We need to continue to build our collective industry experience base to gain transaction efficiencies for smaller markets—the need is there."

IF IMPACT INVESTING WERE A MATURE INDUSTRY . . . "We wouldn't have the added transaction and coordination costs that result from the steep learning curve, allowing programs to be established in smaller markets."

If leaders build the industry, investing for impact could have a powerful role in addressing some of our most troubling social and environmental challenges.

4 WHAT'S AT STAKE: A CALL TO ACTION

Building an industry is challenging in any context, much less in an economic climate that has evoked comparison to the Great Depression. Nevertheless, we are optimistic that some investors will keep insisting that their money be used to create social and environmental impact. The crisis in the financial markets could slow these investors down, or it could speed them up—depending on how governments and intermediaries respond. But it won't stop them. The visible need is too great, as is the impatience with the models of the past that forced those with money to choose only between looking after others (philanthropy) or looking after themselves (investing to grow capital).

The question before us now is whether the conditions of success can be created for those who want to invest for impact, and how quickly they can be created, so that the social and environmental benefits of impact investing can grow as rapidly as possible:

The question before us now is whether the conditions of success can be created for those who want to invest for impact, and how quickly they can be created.

- Will it take the next five to 10 years for leaders to be able to catalyze the marketplace for this style of investing, which in turn would drive sufficient scale to capture value and have a material impact on social and environmental challenges?
- Or will it take 25 years?
- Or will it not happen at all, leaving pioneering investors to fend for themselves and failing to achieve scale?

The global economic slowdown will inevitably alter some tactics and the sequencing. But it does not change the need for the types of initiatives we have outlined, nor ultimately what is at stake in whether leaders emerge and succeed.

Impact investing can only take off and fulfill its promise if enough leaders emerge who are committed to building the industry itself. Given that this is investing, we know that the default will be to put heads down and do deals. As we have said, this is critical—concrete examples of success are essential for any industry to develop. But the history of other industries also teaches that it will not

PROFILE: HABITAT FOR HUMANITY INTERNATIONAL'S FLEXIBLE CAPITAL ACCESS PROGRAM

Nonprofit Accelerates the Development of Affordable Housing in the U.S.

SNAPSHOT

HOW IT BEGAN: Historically, Habitat for Humanity's more than 1,500 U.S. affiliates independently raised most of their capital for home construction for low-income families. They used a portion of their zero percent mortgages as collateral for a loan to build more homes. Each deal term was highly individualized by affiliates and the pool of potential investors small and affiliates devoted substantial time to develop small programs at a local level.

In 1997, Habitat for Humanity International (HFHI) saw an opportunity to improve efficiency and to help affiliates raise capital nationally to increase their ability to develop affordable housing and leverage about a $1 billion pool of Habitat mortgages. HFHI developed the Flexible Capital Access Program (FlexCAP) to allow affiliates to accelerate the receipt of income from their mortgages so that they can more quickly invest the capital to develop more homes in partnership with low-income families. FlexCAP has raised approximately $74 million in loans for more than 200 U.S. affiliates, funding approximately 1,100 new homes. Investors have not experienced a single delinquency to date. HFHI recently further developed its internal infrastructure to support the program and is now raising an $80 million fund over the next five years.

SECTOR: Affordable housing

GEOGRAPHIC FOCUS: U.S.

BASED IN: U.S.

YEAR: 1997

SIZE OF FUND: $23 million outstanding, raising additional $80 million over next five years

INVESTMENT THESIS: FlexCAP allows Habitat affiliates to leverage its pool of mortgages to accelerate home building efforts. HFHI provides its affiliates with a lump sum payment of seven years' worth of mortgage payments. The affiliate then provides HFHI with the actual mortgage payments over the next seven years as well as interest that has historically ranged from 3.25 to 4.00 percent.

PERSPECTIVE

From Cindy Song, director of Capital Expansion and Financial Services

OPPORTUNITY TO SCALE: "HFHI has recently dedicated significant resources to develop the infrastructure to grow this program. Affiliate demand for funding is now three times more than what is was in the previous years because of a decrease in local banking deals due to the current economic environment. However, this environment also provides especially attractive opportunities for land purchase, and HFHI has marketed the program to its affiliates. We believe this level of interest will continue, indicating a great opportunity to scale our future activities."

MIXED EFFECTS OF MARKET DOWNTURNS: "Market downturns pose both an opportunity and challenge for us. While there is greater need for affordable housing, our affiliates are seeing extraordinary opportunities to acquire real estate and contractor services at lower prices, allowing them to stretch dollars further. However, in market downturns, when the need for affordable housing is greater than normal, it becomes harder to raise needed capital at affordable rates."

CHALLENGES:

"We have worked hard to address the perceptions of commercial investors that this type of investing comes with increased risk. We have never had a delinquency and we have a good track record to point to, but the challenge is to overcome their perceptions."

"We invest a lot of effort in each potential investor relationship. Since we have completed rigorous due diligence on a number of large deals, we are hopeful investors will have confidence and build upon third-party due diligence already completed."

IF IMPACT INVESTING WERE A MATURE INDUSTRY . . . "We would have investment banks that would syndicate our deals and allow us to efficiently market our product to a broader group of potential investors."

be enough if potential leaders just do their jobs. There is a strong possibility that failure to build intermediation and infrastructure will lead to the perils of sloppy execution and empty hype. And failure to deal with the lack of clear language and metrics for impact could lead to dilution of standards; no one wants to spend 10, 15, or 20 years developing a new industry only to find that the impact from this work is then questioned or seen as neutral at best.

Our research has led us to conclude that the best way to guard against these risks is to be explicit about them and then take action to build the infrastructure and practices that can enable rigor, discipline, and high standards. Investors, entrepreneurs, and philanthropists all have an important part to play in providing the leadership, capital, and coordination needed to seize today's opportunities. Through effective execution of the strategies in this report, the groundwork of intermediation and infrastructure could be laid to mitigate the risks that impact investing becomes too hard or too easy.

Despite the global economic conditions, progress can be made if bold leaders emerge to play the necessary, collective strategic roles.

Despite the global economic conditions, progress can be made if bold leaders emerge to play the necessary, collective strategic roles. If they do, look for these indicators in just the next few years:

- The development of a few high-profile funds, funds of funds, and investment clubs that bring together impact first and financial first investors to co-invest in deals.
- A group of high-profile investors joining together to articulate their desire to participate in these types of opportunities to their investment advisors.
- Investment banks and other intermediaries (both established and new) beginning to channel more impact investing products to mainstream private banks and wealth advisors.
- An accrediting entity emerging with a compelling approach to metrics that can cast more light on the social and environmental impact of investments.
- An impact investing network serving as the effective platform to advance collective action for the industry (including articulating the voice of impact investors in policy debates), with the participation of those who have the ability to put billions of dollars to work in this industry.

If all this happens soon, within the next five to 10 years, the industry could start to be recognized as a coherent whole, beyond the important geographical and sectoral segments that are its components. The industry would have a greater chance of avoiding the risks of being too easy or too hard. And as we have said, it could grow to be at least $500 billion, about as large as 1 percent of all assets under management around the world in late 2008.

Even if this future comes to pass, and investing for impact achieves its full potential, it will not become a substitute for philanthropy or government, nor should it

be seen as one. Rather, the market will become ever more sophisticated and precise about which funding vehicle best suits which problem. Success will mean creating a meaningful and viable alternative and complement to existing approaches.

Investing for impact can have a powerful new role in the world. With commitment and rigorous action the perils of this moment can be avoided and the industry's promise can be realized, applying the wealth of our era to address some of our most troubling social and environmental challenges.

A VISION FOR THE FUTURE: IMPACT INVESTING AS A MATURE INDUSTRY

During our interviews, we heard time and time again what the future could look like if impact investing became a more mature industry over the next decade or so. Here is a composite picture of what we heard:

- A flood of **high-net-worth individuals** would have moved their money into impact investments with the effective support of their advisors, because dedicated **impact investment banks** and new capabilities within **mainstream banks** would be thriving.
- Many more **impact first investors** would be figuring out how to harness the market to make a difference on issues they care about, generating returns and sometimes providing risk-taking catalytic capital. New **metrics** for measuring social and environmental impact would help demonstrate value and facilitate transactions.
- Many more **foundations** would have become savvy and experienced in investing both program and endowment capital in ways that are consistent with their mission.
- A wave of **individual retail impact investing** would have taken off, spurred by social networking, tied to a positive brand experience and validated by real results.
- **Financial first investors** would be finding many more attractive opportunities that also generate a positive impact, integrating social and environmental considerations into research and investment decisions, and seeking opportunities that at least meet a new minimum threshold for certified impact investments.
- **Corporations** would have started subsidiaries that allow them to leverage existing assets to generate profit while achieving material social and environmental impact.
- Capital would be flowing into the new generation of opportunities that have emerged from **entrepreneurs** who have developed scalable new business propositions in countries around the world that improve outcomes for the poor while yielding significant profits.
- **Investors of different stripes** would be routinely co-investing together, blending their capital through seamless networks and investment clubs into mezzanine investment structures that create the highest leverage of social and financial return. **Philanthropy** would be at the same tables, sometimes joining in on a deal, providing grants for initial technical assistance that can enable a deal to clear—and higher financial returns and impact to be realized.

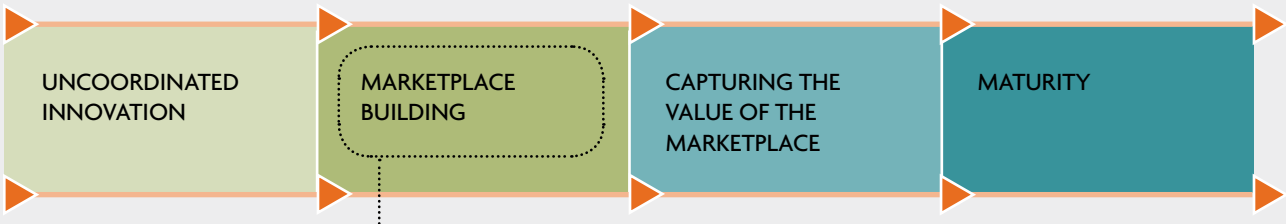
These key initiatives can build a marketplace for impact investing, creating the intermediation, infrastructure, and absorptive capacity required for success.

A BLUEPRINT FOR BREAKTHROUGH: DESCRIPTION OF KEY INITIATIVES

This section provides a description of each of the 17 key initiatives to build a marketplace, including the level of coordination and capitalization required for each to succeed. The initiatives are grouped into three platforms based on the challenges to impact investing:

- *Unlock Latent Supply of Capital by Building Efficient Intermediation*—Enable more investing for impact by building the investment banks, clubs, funds, and products needed to facilitate existing interest.
- *Build Enabling Infrastructure for the Industry*—Build the ecosystem for impact investing including common metrics, language, and an impact investing network that can serve as a platform for collective action such as lobbying for policy change.
- *Develop the Absorptive Capacity for Investment Capital*—Develop investment opportunities and ensure high-quality deal flow by cultivating talented entrepreneurs and supporting the enabling environment for private sector innovation and success in regions and sectors where investment can create impact.

Key Initiatives to Build a Marketplace for Impact Investing



Challenge:	LACK OF EFFICIENT INTERMEDIATION	LACK OF ENABLING INFRASTRUCTURE	LACK OF SUFFICIENT ABSORPTIVE CAPACITY
Platform:	Unlock Latent Supply of Capital By Building Efficient INTERMEDIATION	Build Enabling INFRASTRUCTURE for the Industry	Develop the ABSORPTIVE CAPACITY for Investment Capital
Initiatives:	**A.** Create industry-defining funds that can serve as beacons for how to address social or environmental issues **B.** Place substantial, risk-taking capital in catalytic finance structures **C.** Launch and grow dedicated impact investment banking capabilities **D.** "Pull" existing intermediaries into impact investing by making business commitments **E.** Create investment clubs focused on specific themes **F.** Support the development of backable fund managers **G.** Create financial products to increase accessibility	**H.** Set industry standards for social measurement **I.** Lobby for specific policy/regulatory change **J.** Develop an impact investing network to accelerate the industry **K.** Develop risk assessment tools **L.** Coordinate development of a common language platform **M.** Create publicly available comprehensive benchmarking data **N.** Integrate social and environmental factors into economic and finance theory **O.** Launch a targeted public relations campaign to promote demonstrated successes	**P.** Support effective and scalable management capacity development approaches for entrepreneurs **Q.** Provide tools to support research and development for innovative, scalable models

UNLOCK LATENT SUPPLY OF CAPITAL BY BUILDING EFFICIENT INTERMEDIATION

The lack of intermediation capacity is one of the most significant challenges limiting the ability of investors to find and place capital in impact investment opportunities. This is especially true for impact first and yin-yang investors, because traditional channels do not meet their needs. The following seven initiatives have the potential to alleviate the current constraints in the market by building the intermediation needed to unlock a latent supply of capital.

A. Create industry-defining funds that can serve as beacons for how to address specific social or environmental issues

- **Goal**: Stimulate the market's development by attracting talented entrepreneurs to launch businesses and intermediaries while consolidating capital and reducing transaction costs associated with fragmented supply. Funds could also create platforms to seed and build the capacity of new fund managers and to roll out impact metrics or standards in ways that reinforce the funds' financial objectives.
- **Potential Initiative**: A collection of investors commit $1 billion to an impact investing fund, which attracts fund managers, service providers, and entrepreneurs to the field. This could kick off a virtuous cycle as it becomes easier for additional investors to engage in impact investing, which in turn attracts more entrepreneurs and creates more business for intermediaries.

Describing what could catalyze the industry, Jason Scott of New York-based EKO Asset Management Partners says: "Create a really big fund through credible organizations guaranteeing 5 to 8 percent to investors, operating the right way, using some philanthropic capital (say, $10 million), monitoring progress, and with clearly stated social outcomes such as 10 million tons of carbon reduced or 1 million jobs created."

A small number of large scale investors, such as sovereign wealth funds or even universities, could trigger something similar on their own. The results for the industry will be greatest if there were a high level of visibility and influence for the fund. As Preston Pinkett, director of Prudential Social Investment, describes it: "In the best of all worlds, the 10 largest foundations—plus Harvard, Yale, Princeton—would decide to invest all of their endowments in the social impact space. This would create a chain of events that would create the required market . . . or at least 88 percent of it." That said, a fund may be most readily established by strategic investors whose reputation makes the ripple effects across the industry most credible and powerful. A good example of this type of "800-pound gorilla" could be CalPERS (the California Public Employees' Retirement System); when it starts strategically allocating to a sector, it influences the behavior of a wide range of other actors.

Ideally large funds would be developed taking different approaches, thus creating a healthy amount of competition between funds. A single marquee fund could also accomplish some of these objectives, though other significant players may be disinclined to emulate it since "eagles don't flock."

In another approach to this initiative, an entrepreneur or existing fund could launch a fund of funds that provides investors with an accessible vehicle for putting capital to work in credible impact investments and widening the investor base beyond the relatively sophisticated investors who currently have the resources and conviction to seek out and vet investments.

B. Place substantial, risk-taking capital into catalytic finance structures

- **Goal**: Stimulate the development of impact first and yin-yang investment opportunities while lowering transaction costs for asset owners, co-investors, and capital recipients.

- **Potential Initiative**: Create a concessionary capital fund that can nimbly match its funds with more commercially oriented capital. The fund might focus on providing secondary financing to allow primary investors to exit while leveraging their expertise in deal sourcing.

The power of risk-taking capital to create leverage is compelling. For example, Prudential Social Investment provided a $5 million equity investment into the community bank ShoreBank. The investment enabled others to finance ShoreBank with lower-risk debt and cash deposits, among them TIAA-CREF, which made a $50 million cash deposit into ShoreBank as part of its impact investment portfolio. Calvert Foundation's Community Investment Note program has generated a pool of more than $150 million in soft-priced capital funded through retail and high-net-worth investors that finances more than 200 nonprofit intermediaries, leveraging subordinated investments from major foundations.

While some funders provide risk-taking capital, there is significant leverage in greater coordinated action. There are many examples of high-net-worth individuals, foundations, and development finance institutions that provide "soft" capital disjointedly.

But because the market is filling up with entrepreneurial activities, there is a growing risk that market distortion will occur if the innovation phase goes on too long. For example, investors who are limited partners in a fund may be providing grant funding to the portfolio companies that fund invests in. This does not serve the individual organizations well and drains the whole system of a scarce resource.

Moreover, development finance institutions tend to have strict rules and slow processes that make it hard for them to deploy capital nimbly. Pooling capital into a separately managed entity may increase flexibility.

Finance structures can enable investors to take different returns from an investment. They can also enable investors who seek to catalyze deals to take on greater risk without compromising return. For example, a foundation-sponsored concessionary capital fund might take a "barber pole" approach to returns where it accepts lower returns first and waits until other investors have been paid out before taking its full return.

C. Launch and grow dedicated impact investment banking capabilities

- **Goal**: Develop services such as deal origination, deals structuring for different types of capital, syndication, aggregation of smaller investment opportunities into portfolios for large investors, and help facilitating exit opportunities. These capabilities will be important across all segments, but especially for the impact first and yin-yang investors for whom traditional intermediation is likely to fail.

  As Lila Preston at Generation Investment Management explains, "Trusted intermediaries that can aggregate and vet projects would enable investors to participate in a more scalable manner. Intermediaries can reduce risk and transaction costs and provide verification, monitoring, and other infrastructure. Currently there are only a few, and they are small and sector focused."

- **Potential Initiative**: Entrepreneurs, boutique microfinance investment banks, or mainstream investment banks launch and grow social investment banking businesses to facilitate impact investments. Investors could commit business to scale these banks, and collective action by investors to demonstrate demand could help spur development of the necessary capabilities.

For example, these services may emerge from existing banks, like J.P. Morgan, which launched a social sector finance unit in 2007. Boutique firms are also emerging, such as San Francisco-based Imprint Capital Advisors, which operates exclusively on the buy side; Intellecap, which has deep knowledge in local markets, particularly India; and Lion's Head, a London-based firm whose principals have deal-structuring skills rooted in experience putting together the issuance of multibillion-dollar bonds for life-saving vaccines for children in poor countries.

D. "Pull" existing intermediaries into impact investing by making business commitments

- **Goal**: Organize commitments of business to specific intermediaries to provide them with material incentives for engaging in impact investing.

  As Chris Foy of Sainsbury Family Investments notes, "Floodgates only open against pressure."

- **Potential Initiative**: Investors clearly express interest in impact investing in the form of visible deal flow or committed long-term interest, thereby enabling an intermediary to develop expertise based on anticipated demand. These investors might act individually or in a coalition and could include high-net-worth individuals or wealth advisors and private banks acting on behalf of their clients.

Many of the entities interested in impact investing are prestigious and well resourced, with the ability to constructively wield their power as buyers of financial services to motivate the intermediaries that serve them. Investors should focus on networks in which they can most effectively amplify their demand for these kinds of services.

For example, a group of three U.S. foundations—the F.B. Heron Foundation, the Annie E. Casey Foundation, and Meyer Memorial Trust—banded together and had investment advisor Cambridge Associates conduct research on impact investing options for endowment managers. As a leader at one foundation puts it: "When important players act, they are able to influence other players to follow suit, as was the case with Cambridge Associates offering investments cognizant of environmental, social, and governance issues to their clients . . . Adoption by large, prestigious institutions is the most important step in order to legitimize the space."

There is the potential for other types of investors to do the same. Individual investors, for example, can go to their money managers and convey how important it is to them. As Dr. Ivo Knoepfel, founder and managing director of the Zurich-based investment advisory firm onValues, explains: "It is important that high-net-worth families express a clear demand for impact investing. This will prompt banks to develop the necessary products and services, as was the case for microfinance."

E. Create investment clubs focused on specific themes

- **Goal**: Bring together financial first and impact first capital to share deals and broker co-investment on targeted issues or regions.

  Impact investing at its best can connect deals and investors in ways that are not otherwise possible, expanding existing networks and reducing the potentially prohibitive cost of doing deals one by one. This will especially be the case when trying to put together capital from different worlds into yin-yang deals.

  As Mitchell Strauss, director of Credit Policy at the Overseas Private Investment Corporation, the U.S. finance institution that seeks to mobilize placement of private capital in less developed markets, puts it, "None of this is rocket science, but a collaborative approach from funders with different return expectations, coupled with technical assistance on the side, is necessary to get deals done."

- **Potential Initiative**: Investors develop networks that allow them to come together, share due diligence, and co-invest.

Two types of clubs might be developed. One form would involve only investors with a goal of aggregating investors to improve deal flow. For example, Investors' Circle has provided an important forum for a subset of early-stage investors to gather.

A broader model of a club might also include a network of technical assistance providers for the social and/or environmental aspects of their investments, enabling investors to assess investments with lower transaction costs. The network could include research institutions, community organizations, environmental engineers, and activists who can help to develop and implement sustainable impact in the chosen investment area, potentially as an online business that allows

access to targeted expertise. This would not only enable investors to collaborate more effectively but would also help potential partners overcome what can be an aversion to capitalism as a means to achieve their mission.

For either type of club, success will require thoughtful collaboration, a long-term perspective on the part of investors, and putting time in to build the network, which may not be economically justified in the short-term.

A newer effort underway along these lines is a working group formed in 2007 at a meeting hosted by the Rockefeller Foundation called Project Terragua, which aims to develop and demonstrate the viability of a new model for African agricultural investment that can generate positive social and environmental return.

F. Support the development of backable fund managers

- **Goal**: Develop management capacity for fund managers so they are better equipped to identify high-quality management teams and investment opportunities.

  As Charles Ewald of New Island Capital explains: "If I could change one thing it would be to bring more seasoned investors and management teams into the field. You currently find people with tremendous potential but limited experience. There are investors who have never seen a full cycle. Good intermediation is also necessary. Ultimately, the viability of the field will depend on the quality of the investments made and the companies created."

- **Potential Initiative**: Create funds or fund programs that help develop emerging managers with the necessary training and the capital needed to cover their costs—as well as the capital for them to manage in their fund.

A fund could issue a request for proposal for different types of products—for example, awarding five $100 million mandates to managers who offer a product that meets its broad specifications.

Conceivably, hedge funds and private equity firms might send out people to train the fund managers using a mentorship model, which would help retain employees (potentially as a sabbatical program) while developing a robust stream of high-quality fund managers.

Some funds do this already. For example, the business model of Small Enterprise Assistance Funds, which has managed 23 funds around the world over the past 20 years, is based on investing in and developing on-the-ground managers whose local insights can find the best opportunities. The United Nations Environment Programme Finance Initiative provides forgivable loans to new fund managers running sustainable funds. More efforts like this will be needed to develop relevant expertise and experience among fund managers.

G. Create innovative financial products to increase accessibility

- **Goal**: Provide more investment opportunities while reducing risk and transaction costs.

- **Potential Initiative**: Create vehicles and mechanisms for different types of capital that can serve as "on ramps," enabling funds to be more readily placed into impact investments. This might include applying financing structures in creative ways—for example, using collateralized debt obligations backed by a portfolio of loans to microfinance institutions. Blue Orchard did just this, enabling it to tap mainstream capital markets for $87 million in 2004-5, which was just the start of a set of similar transactions.

Given the financial market crisis of 2008, investors may be highly wary of products that lack transparency. But clear products might present attractive options, such as creating a fund of funds specifically designed to enable investors with large pocketbooks to try out impact investing while spreading their risk. Further opportunities lie in the donor-advised fund universe. Calvert Giving Fund provides a set of impact investing opportunities for their donor advisors, with the potential to tap the approximately $20 billion in conventional donor-advised funds.

The objective of many new products may be to aggregate a set of opportunities that make it easier for an investor to jump in to make an impact on an issue or set of issues they care about. As Jason Scott at EKO Asset Management

Partners Partners explains, "Bundle together enough product in areas that are similar or have similar risk-return criteria—such as microfinance, community development, and environmentally related assets—and that would really make a difference." Blue Orchard's Oasis Fund, which provides equity and loans to social and environmental ventures around the world, and responsAbility's new bottom of the pyramid fund cross market sectors and enable easy market entry.

A fund manager could decide to create this type of on-ramp, or an anchor investor could decide to become the lead investor in developing it.

BUILD ENABLING INFRASTRUCTURE FOR THE INDUSTRY

Efficient intermediation alone cannot accelerate impact investing, given the challenges constraining the industry and the risk that impact investing may become too hard or too easy. Basic infrastructure must also be built to enable metrics for impact, develop a common language, integrate social and environmental factors into economic theory, and to make visible the demonstrated successes of impact investing.

Transforming the ecosystem will require the bold step of developing an impact investing network that can serve as a platform to enable the other infrastructure initiatives that require collective action. And ultimately, policy may be a critical lever to motivate massive amounts of capital to engage in impact investing.

Building the infrastructure required for a successful industry will be challenging. Most of the following eight initiatives will require industry-level coordination as well as some subsidy upfront. While most of these initiatives will be important for all segments of investors, only those actors interested in creating public goods are likely to initiate or sponsor them. But if executed successfully, these initiatives would yield tremendous benefits.

H. Set industry standards for social metrics

- **Goal**: Foster the development and adoption of metrics to enable: 1) investors to understand the social/environmental aspects of investment opportunities and 2) intermediaries and capital recipients to communicate their impact and justify the return they can offer.

  As a portfolio manager at a major U.S. pension fund explains: "Measurement of 'ancillary' benefits is going to be an ongoing issue in impact investment. The industry needs to capture and demonstrate these benefits in order to attract more capital."

  As of 2008, individual actors on both the buy side and the sell side are developing their own metrics, which is massively duplicative. Standard metrics will improve investment efficiency by facilitating benchmarking, identification, and uptake of successful business models and co-investment. As Dan Letendre, managing director of the Merrill Lynch Community Development Company, notes: "Imagine a commercial investing world in which there aren't any rating agencies, or quantitative or qualitative risk measures: there would be no money coming into this world. As an industry we have not built tools or vocabulary that allows us to communicate risks and rewards."

- **Potential Initiatives**: Two key initiatives would help achieve this goal: developing rigorous metrics and a standard-setting body to implement them.

For impact first investors, the most important priority is to develop rigorous metrics for assessing the relative social and environmental impact of investments and portfolios within and across the sectors and geographies that matter to them. This would allow them to assess the results from investments that may be below market rate; understanding this potential tradeoff will be especially important to institutional investors. Developing comparative metrics will be challenging—it has long been one of the toughest nuts to crack in the social sector.

An additional step would be to establish a standard-setting body that would help create a threshold for what would be considered an impact investment. A basic rating system would help organize the market by making it possible to compare outcomes of investments. It would also help protect the credibility and reputation of the field from conventional investments being promoted as impact investments. As one foundation leader puts it, "To address the integrity con-

straint, certification has to set a floor instead of a ceiling as the industry can't make the mistake of reaching too high."

Effective action around either of these forms of initiative is most likely to come from capital providers who would need to coordinate to form standards for benchmarking jointly, informed by sell-side companies. At the same time, success of this initiative would require these investors to give up some level of specific interests that might otherwise necessitate total customization of reporting. Ultimately the movement of a critical mass of investors will be required for a standard to take hold.

There is much to be learned from the standards-setting activities in socially responsible investing, including the framework of the Global Reporting Initiative and the Ceres Principles.

Other industries provide helpful analogues. For example, financial first investors might be interested in a type of metric that communicates simply whether an investment is an impact investment at all without needing to dig into too much technical detail. The Forest Stewardship Council (FSC) provides third-party certification for timber with a single globally accepted standard. Similarly, the U.S. Green Building Council developed the Leadership in Energy and Environmental Design (LEED) standards as a nationally accepted benchmark, and acts as a third-party certification program. It has developed specific ratings (e.g., platinum, gold, silver) that are customized into versions for different types of buildings such as retail and schools. These standards are a powerful communication tool. Executives may not be experts in exactly what the FSC or LEED standards mean—but they know they want their wood and buildings to meet those standards.

A new effort called Project Galileo is working toward the goal of this initiative. The project is being pursued by a working group of the Global Impact Investing Network and takes its name from the early 16th century astronomer who offered reasoned arguments that challenged prevailing ideologies and allowed us to see the world in a new way. Support for this work or the launch of competing approaches—whether through applying and testing metrics or providing startup capital for a standards-setting body—will be required to create the analytic tools and infrastructure needed to place assessment of social and environmental value at the heart of an investment, rather than as its coincidental side effect.

Acumen Fund is also working with Google, salesforce.com, and others to develop a data management solution that would enable customizable financial and impact data to be more easily compared across current or potential investments.

POLICY AND REGULATORY CHANGE: THE NETHERLANDS

To foster green investments, a Green Funds Scheme was introduced in the Netherlands in 1995, granting tax reductions for qualified projects, such as wind farms or organic agricultural businesses.[27] The Ministry of Housing, Spatial Planning and the Environment assesses whether projects meet the required definition.

Tax reductions are 1.2 percentage points on capital gains, and borrowers are given an additional tax reduction of 1.3 percentage points on the value of the green investment. Banks offer green bonds or shares in green funds. So far, the Green Funds Scheme has attracted about 200,000 savers and enabled around 5,000 green projects worth about five billion Euros.

The Green Funds Scheme came into being because of the initiative taken by several investors who worked closely with government officials. Paul McKay, who was then serving as managing director of Triodos Bank, brought several bankers together with two members of parliament at a seminar to discuss the opportunity. The bankers advocated for a tax break to make green investing commercially competitive and attract significant private sector investment. The parliament members embraced the plan and gained the support of civil servants with environmental and tax expertise who helped craft the legislation, which was passed into law about two years later.

Building upon the success of this tax incentive, the government later passed similar incentives for investing in microfinance and cultural projects.

I. Lobby for specific policy/regulatory change

- **Goal**: Develop and advocate for policy/regulatory changes that would dramatically increase the level and efficacy of impact investing in various national contexts.

  As Sir Ronald Cohen, a venture capital pioneer in the U.K., notes, "The role of government now is an enabling one, to provide significant incentives for the creation of the 'social investment' system and the development of mission-driven organizational and investment models that are capable of wide replication."[28]

  Policy mechanisms have the potential to change the underlying risk-return tradeoff and address structural barriers through legislation and incentives. While some people in the financial industry tend to undervalue the importance of policy, it has been critical in accelerating other industries, including venture capital and community development finance.

- **Potential Initiatives**: Policy mechanisms could include anything from a reduced capital gains tax on impact investing products to scrutiny and clarification of the meaning of 'fiduciary duty' or to the development of a fund to catalyze impact investments similar to the Community Reinvestment Act, but for a broader set of social and environmental issues. Governments could also leverage their role as large-scale purchasers by providing anchor demand for promising enterprises, enabling them to prove and scale their business models.

Although typically an initiative like this could take a bit longer to come to fruition, the financial market crisis of 2008 has created a unique window of opportunity for policy change, potentially as part of a larger package of regulatory changes. In the United States, an anticipated jobs program—centered on green energy infrastructure and developed to entice private investment capital—is a particularly compelling early opportunity for impact investing policy. Ultimately such a policy has the potential to transform both the economics—and the mindset—about the value of impact investing.

Most of these kinds of policies will not emerge from mass campaigns but will require effective leadership and lobbying in national contexts.

A handful of countries have already begun to take steps in this direction. The Community Reinvestment Act in the U.S., passed in 1977, was pivotal in creating the community development finance industry that has since poured billions into otherwise underserved neighborhoods. (Although some have wondered whether there is a relationship between the CRA and the lending crisis, most experts agree they are completely unrelated. Subprime loans were generally originated by institutions not subject to CRA, CRA loans were not securitized and CRA loans and securities are in fact performing reasonably well.)[29]

The U.K. set up a similar arrangement with the Community Investment Tax Relief Scheme in 2002. In South Africa, the Black Economic Empowerment Program has increased the potential to invest in ways that create impact. In so doing it has spawned entrepreneurial startups like the Sasix Financial, started by the South African Social Investment Exchange, which lists opportunities for investment that yield financial returns and holds investees accountable for social performance with independent research, evaluation, and monitoring. In India, a set of Priority Sector Lending Guidelines issued in 2007 has created loan targets for banks in such areas as small and medium enterprises, education, and housing.[30]

In the U.S., these policies might help address the scrutiny facing many types of capital in 2008. For example, if the pressures to change the tax treatment of carried interest for private equity firms continue, an exemption potentially could be put in place for impact investment funds to continue to be treated favorably.

For foundations and universities feeling pressure to increase the rate of spending from their endowments, tax-favorable treatment of impact investments would provide a way to keep funds invested, while generating additional public value to validate their tax-exempt status. For example, a big group of foundations, university endowments, and pension funds could get together and create a multi-billion dollar fund, engage the Treasury Secretary in a conversation about the challenges and opportunities of the field, and explain that they are willing to do something about it. What they need is a Community Reinvestment Act-like benefit so they can go innovate and try this type of investing. If it works, in five

years there will be a whole new flood of investment opportunities that also create impact—a win/win for everyone.

Other types of reforms could involve a re-examination of how laws about fiduciary responsibility are interpreted. As one private banker notes, "An extremely important step is to redefine the duties of a board member of foundations, large institutions, pension funds, and other commercial sources of capital, to force them to consider the impact of their investment decisions."

Governments can also provide anchor demand to growing enterprises, enabling them to sufficiently prove their models so they become investable propositions. For example, in India, the only three organizations creating internet kiosks that have reached a scale of at least 1,000 kiosks were all initially funded with government support.[31]

J. Develop an impact investing network to accelerate the industry

- **Goal**: Build a network of leaders who can steward the industry forward in a strategic way. The network can enable impact investors to build relationships, share experiences, pursue investment opportunities, and forge partnerships, and can serve as a source of information for organizations committed to field building. The network would be particularly valuable for deals that mix impact first and financial first investors.
- **Potential Initiative**: Investors build a global network for the impact investing field that serves as a hub for collaboration and a platform for setting clear definitions and standards. Investors develop relationships for sharing information, co-investing, and engaging in new projects. The network also provides the community with a common voice in policy advocacy efforts.

Today there are a number of national and even global networks playing important roles in specific arenas, such as the Emerging Markets Private Equity Association, Investor's Circle, the More for Mission Campaign, PRI Makers Network, Social Investment Forum, and Social Venture Network. However, there is no global network designed to serve impact investing as a whole with a focus on suppliers of capital and intermediaries.

Establishing a global network of impact investors would help address the inefficiencies caused by the isolation and fragmentation in today's market. It would provide a forum for investors to find partners and learn from their peers' experience and experimentation. A network would also accelerate the development and implementation of other initiatives by providing a space for coordination and collective action. For example, a network could serve as a locus for coordinating the development of metrics, launching a targeted public relations campaign, or even advocating for policy incentives for impact investing.

The network could be governed by a representative group of investors who would guide its activities to respond to the evolving needs of the investor community. The network membership could also serve as a source for information about barriers that could inform the development of new initiatives and help guide the efforts of leaders committed to building the field.

Networks have played an important role in the development of other industries. The National Venture Capital Association in the U.S., founded in the 1970s, evolved to become an important advocate for supportive public policies. It hosts working groups that have focused on spaces like clean technology, healthcare, and human capital. Similar networks have sprung up elsewhere, including the Latin American Venture Capital Association and the African Venture Capital Association, among others. In microfinance, the Consultative Group to Assist the Poor (CGAP) has played an important role in creating infrastructure. In addition to distributing industry information and research, it has helped develop standards and capacity building programs for the field and has incubated important initiatives, such as the development of ratings agencies.

The early-stage development of a global network is already beginning, emerging out of two convenings held by the Rockefeller Foundation in 2007 and 2008. The group of investors is designing the Global Impact Investing Network to bring together impact investors and intermediaries who have the capacity to invest and intervene at scale, making multi-million dollar investments and aggregating funds large enough to access institutional capital. It will include both impact first and financial first investors and is intended to support activities that facilitate a more efficient yin-yang deal space.

K. Develop risk assessment tools that can increase the visibility of and access to marketable products

- **Goal**: Increase the engagement of investors—especially financial advisors—in impact investing by helping them better understand investment opportunities, assess risk, and find approved products.

  The financial crisis that took hold in 2008 has made investors question their assumptions about risk in the general markets. But lack of understanding of risk associated with impact investments was a challenge for the industry even before then. As Dan Letendre, managing director of the Merrill Lynch Community Development Company, notes: "The single biggest constraint hampering growth is perception of risk. There is a real lack of knowledge and understanding of risk." Elliot Berger of Merrill Lynch's Private Banking and Investment Group adds: "Many advisors don't understand the risk and opportunities [in impact investing]. At many levels, enabling the movement involves us educating our sales force and financial advisors." More transparency and methodologies to analyze risk and other information will be all the more important given the market crisis.

- **Potential Initiatives**: At one level, investors putting time into rigorous due diligence could share that due diligence with others who can use it to understand risks and accordingly make more effective decisions. More accessible information would reduce the transaction costs and increase the quality of information available to investors. In addition, as the market matures it will become possible to create or invest in vehicles and tools that help investors and their financial advisors more readily identify and analyze impact investments, including ratings of the risk factors associated with different types of investments. Entrepreneurs or existing advisory firms could develop these tools or demonstrate demand for the services on behalf of their private wealth clients. And eventually, programs could be launched to incorporate impact investing in the chartered financial analyst curriculum.

The lack of understanding of risk is partly due to limited experience, as well as the mindset that accompanies the absence of a track record. In a new market, investors prefer to do their own due diligence and analysis, putting their sweat in to find and vet good deals.

Over time, as standards and benchmarks develop and the pool of data points becomes larger, ratings systems can become helpful to some investors for certain types of deals. Some investors will always do the legwork themselves—and this is more likely to be true of financial first investors relative to impact first investors (conversely, impact first investors may prefer to do the legwork on impact ratings themselves because it is the value creation they care about most, while financial first investors may outsource that to others).

On a structured finance deal, ratings agencies could help rate bonds (even if their credibility has been somewhat undermined by the financial crisis). For funds, the diligence of an investment advisor and the listing of the fund on an approved list serve a similar function. For private transactions, a strong lead investor is a proxy for the quality of the deal. And other times, calling in a third-party advisor familiar with the sector may be the preferred option.

For example, London-based Investing for Good has developed a tool that includes a rating of "confidence" to help wealth advisors select appropriate opportunities and communicate about them. Although Investing for Good initially marketed this service to individual wealth advisors, it has increased traction by pursuing a more wholesale model, gaining support of senior management at leading European private banks, who have pulled entire groups of wealth advisors onto the Investing for Good platform.

L. Coordinate development of a common language platform

- **Goal**: Develop a language platform to give investors greater definition and clarity about the ecosystem—the ways in which impact investing is one thing and the ways in which it is many things that should be distinguished—so they are able to communicate and collaborate more effectively.

- **Potential Initiative**: Create clearer definitions and greater standardization of approaches within relevant segments.

This report is intended to be a step in the right direction, helping highlight some of the commonalities and some of the areas of difference. But more needs to be done to ensure we move forward from the unfettered messiness of terms to greater clarity and efficiency.

For example, standardizing documentation for investment opportunities (e.g., term sheets) would enable comparability of investment opportunities and reduce transaction costs, especially for impact first investors and yin-yang deals. In the venture capital world, model documents for first round financing have been developed by working groups of the National Venture Capital Association. As Tom Haslett, who runs Africa Health Fund, notes: "We need to create standardized term sheets for the industry. If we can create a library from five funds and get them all to talk the same language, it would benefit this space tremendously." The termsheets might also make it easier for institutional investors with extensive legal processes because there would be a pre-vetted and approved set of terms as a starting point. The recognition of the need for standard language, deal terms, and accounting metrics is already at the forefront of many investors' minds and is attracting wider interest. In 2008, one of the Big Three international accounting firms was approaching impact investing intermediaries and investors with an interest in participating in this work.

M. Create publicly available comprehensive benchmarking data

- **Goal**: Allow market visibility, benchmarking, and comparability of performance.
- **Potential Initiatives**: Provide a service to inform investors about potential options in different sectors, regions, and asset classes to enable them to understand what their choices are. Or create a data clearinghouse to collect, scrub, and aggregate financial and impact performance data from impact investment funds.

The initial, more basic challenge in the market will be to establish visibility so actors have a sense of who is doing what and how to find potential deals in areas they care about. This need will continue to exist among investors new to impact investing who may want to learn about what their options are if, for example, they want to invest in bonds that provide funding for businesses serving the very poor in Latin America.

Once investors have that basic orientation, they (and potentially funds as well) would likely find it valuable to be able to turn to a set of data that allowed them to compare their approaches and results to identify top performers. In the venture capital industry, VentureOne performs this function. Although funds may be reluctant to disclose this information in an attributed way, even aggregate data sorted into basic quartiles can provide useful information to understand and assess relative performance.

This benchmarking can also occur at the portfolio level. For example, the K.L. Felicitas Foundation, which currently has 30 percent of its portfolio in a variety of mission investments, shares its performance relative to a publicly disclosed universe of similarly sized foundations. It has performed in the top decile of its peer group in the last one-, three-, and five-year periods.

N. Integrate social and environmental factors into economic and finance theory

- **Goal**: Integrate social and environmental factors into economic and finance theory to increase their legitimacy in the financial community and incorporate them into financial education.
- **Potential Initiative**: Fund or pursue academic research on the relationship of social and environmental factors to economics and finance.

Incorporating social and environmental factors into economic theory could advance mainstream thinking on impact investing, much as the work done by environmental economists has contributed to such topics as carbon pricing and liability.

Domini Social Investments is starting to explore efforts in this arena. As Steve Lydenberg from Domini sees it: "Modern portfolio theory cannot contend with social and environmental issues and thus holds institutional investors back from investing in this space. Modern portfolio theory needs to change." The growing field of behavioral economics appears particularly poised to provide insight into impact investing.

Additional efforts might include convening a roundtable to discuss pricing assumptions for sub-market rate deals. A challenge in organizing syndicates for some impact investments lies in the lack of standardized pricing models (spread-based or otherwise) for sub-market rate investments. An example of the kind of challenge investors face, which a roundtable might productively address: what should the cost of senior secured debt be for a high-impact organization?

O. Launch a targeted public relations campaign to promote demonstrated successes

- **Goal**: Address the negative perception associated with impact investing among investors and intermediaries and stimulate demand among high-net-worth individuals and influencers by highlighting examples of successful investments. At the same time, ensure transparency and education about both risks and rewards in this sector.
- **Potential Initiative**: For broad impact, a campaign will require coordinated action by both buy-side and sell-side actors—for example, entrepreneurs and leaders of private banks, potentially led by an impact investing network or other set of networks. There may also be more entrepreneurial ways to jumpstart a campaign to elevate the profile of realistic investment opportunities, such as publishing a list of the top 10 impact investing deals of the year.

These efforts would help make success stories public, which is seen as important in many different geographies. As a corporate leader in the Philippines notes, "Success stories of impact investing could lead to huge demand, as investors need to see evidence of the opportunity." Or as Dr. Ivo Knoepfel, founder and managing director of the Zurich-based investment advisory firm onValues, puts it: "Investment consultants and specialist media should contribute to awareness building and to more clarity in this area. The 'double dividend' proposition of impact investing (financial and social returns) should be explained and quantified better."

The audience may be quite targeted. As Craig Metrick, U.S. head of responsible investment for Mercer Investment Consulting notes, describing how firms begin to engage: "In a lot of cases someone at the top of the institution has an interest in impact investing or believes that it has a role to play in the organization's long-term strategy. I believe that it is mostly a top-down phenomenon."

An analogue for this initiative would be the targeted efforts made by actors in microfinance to have an International Year of Microcredit at the United Nations in 2005, an effort that helped pave the way for the awarding of the Nobel Peace Prize to Muhammad Yunus in 2006. It is worth noting that this came on the back of a few decades of hard work building up successful business models in the microfinance field; many sub-sectors within impact investing are not yet at this same stage of readiness and maturity.

A different approach might be to highlight top performers periodically, much as the international collaborative Enhanced Analytics Initiative highlights institutions that provide the best analysis of extra-financial issues, including climate change and corporate governance.

The goal is to build the industry while avoiding hype.

DEVELOP THE ABSORPTIVE CAPACITY FOR INVESTMENT CAPITAL

Building the marketplace will also require developing attractive opportunities in which to place investment capital. As of 2008, most investors report that intermediation, rather than availability of impact investment opportunities, is the constraint on capital flows in most sectors and geographies. However, many also said that in the next few years they believed the constraint could well become the number of viable deals with scalable models into which sufficiently large amounts of capital can be efficiently invested—especially if more capital pours into the market. But an increase in the supply of capital, enabled by improved intermediation, could potentially take care of this problem, creating incentives for the development of new entrepreneurial ventures much as it has in the venture capital industry.

This chicken-and-egg problem is really an issue of timing. It may be too long to wait until perfectly functioning intermediation is in place before cultivating the demand for capital. Some support will likely be needed as the supply of capital is becoming unlocked. The following initiatives would help accelerate progress and enable the industry to grow by building investment opportunities.

These initiatives are especially important for financial first investors, since a sufficient number of deals yielding attractive returns will become a constraint on their ability to invest. However, impact first investors are most likely to pursue these initiatives and help bring business models to a commercially viable stage.

P. Support effective and scalable management capacity development approaches for entrepreneurs

- **Goal**: Develop management capacity for demand-side entrepreneurs to increase the quality of investment opportunities.

  As Nachiket Mor, president of the ICICI Foundation for Inclusive Growth in India and chair of IFMR Trust's Governing Council explains, "In the IFMR Trust we are eagerly looking for highly skilled individuals that combine a strong desire to have social impact with the profile of a 'lean-mean-money-making-machine' so that the large majority of investors, those that exclusively seek strong financial returns, feel that their money is in safe hands and are persuaded to the invest large sums required to have scaled impact."

  In well-developed economies, this role tends to be seen as the responsibility of government—for example, through small-business associations. In developing economies, traditionally the role has been played by philanthropy or development aid, although private capital is playing a growing role in order to ensure an attractive and sufficiently large pipeline.

- **Potential Initiative**: Identify and fund the most efficient programs that help develop leaders of enterprises with investable propositions, create platforms to link businesses to existing supply chains, and offer tools to provide the missing elements of the entrepreneur's ecosystem such as support for research and development.

Generally, the provision of technical assistance scales most effectively when integrated with capital investment. Increasingly, innovative private equity and debt funds are building assistance into their models, including organizations such as Small Enterprise Assistance Funds, Root Capital, and Grofin, who are scaling lending and investment into the hundreds of millions of dollars across Latin America, Africa, and Asia. Some funds, such as Acumen Fund (which works globally), will provide this support as a condition of investment. In other cases, assistance is treated as a service that portfolio organizations pay for (e.g., for Business Partners International, in South Africa). A different business model provides technical assistance to support growth without funding, as with such organizations as Technoserve and Endeavor.

While technical assistance may need to be fairly customized, funds can also improve their selection of viable opportunities and better support entrepreneurs by ensuring they have a basic understanding of what archetypes of business models have the potential to scale. For example, understanding whether it makes sense to invest in a solar lantern plant for serving the very poor in developing countries depends upon understanding the ability of target customers to pay.

In addition, many entrepreneurs would benefit from platforms that enabled them to link into existing supply chains. A fund could provide the relevant connections if it had strong relationships in a given sector—or this could be a way for an entrepreneur or corporation to get directly involved in developing this for their supply chain.

The success of this initiative will require limited partners to recognize that general partners playing this role may require greater remuneration, whether in the form of higher management fees, a larger carry, or a subsidy.

Q. Provide tools to support research and development for innovative, scalable models

- **Goal**: Enable the development of scalable business models.
- **Potential Initiatives**: Fund the research and development of new, relatively simple models that have the potential for broad replication.

Innovation is key to creating the new models that will enable impact investing to generate returns while delivering social and environmental benefit. One way to foster innovation is to support entrepreneurs with research and development. For example, with microfinance, Grameen essentially developed this innovative approach to lending. Other organizations then copied it, benefiting from the fact that somebody else had already paid for and conducted the research and development.

Innovations with greater replicability have the potential to be implemented and delivered more broadly and therefore to create more impact. However, this very replicability may make it more challenging for the developers to capture the

IDENTIFYING SCALABLE APPROACHES IN INDIA: MONITOR'S INCLUSIVE MARKETS STUDY

Although India is one of the leading markets for enterprises that have the potential for financial and social return, Monitor's Inclusive Markets practice has observed that outside the same set of four or five well-covered examples—AMUL, Aravind Eye Care, ITC e-Choupal—very few of these promising initiatives aimed at the poor have achieved meaningful scale.

To understand why, and to identify the business models that have the best prospects to get to scale, a Monitor Inclusive Markets team spent a year analyzing market-based solutions in India. The study was limited to socially beneficial products and services, as well as livelihoods, and focused on the bottom 60 percent of the income distribution.

This detailed study covered over 270 different approaches to development challenges in 18 states and 10 different sectors, including water, health, agriculture, construction, education, off-farm rural livelihoods, and financial services. The research was conducted through in-person interviews with both promoters and funders, and in more than 30 cases included extensive field work including primary customer research, competitor/substitute interviews, supply chain field visits, and sales tracking at individual farm markets.

The work identified eight business models—many of which cut across sectors—that have either a proven ability to scale, or a demonstrated promise that they could scale, while still providing social benefit to the poor and being commercially viable. Three examples of promising business models include:

- The use of "para-skilled" labor in order to lower the cost of service delivery, for instance, high quality primary education for $3/student per month
- "Pay per use" infrastructure, for instance 12 liters of clean drinking water for $0.03/day
- Contract production in agriculture, livestock, or crafts as a way to generate livelihoods and incomes, sometimes with an income effect of over 100 percent.

In addition, the study provides a number of other conclusions about lessons from successful approaches to scaling, pitfalls in the distribution of socially beneficial products, expectations for large companies versus smaller social enterprises entering the field, and implications for policymakers, investors, and other funders.

These findings will be published in early 2009 and can be found on the website for Monitor Inclusive Markets at www.mim.monitor.com.

value of their model. For example, while the well-known Aravind Eye Hospital provides a highly effective model for serving poor patients in India, it has not been replicated, probably because, like many highly innovated approaches, the model is too hard and complicated to copy.[32] This tension may create a disincentive for financial first investors—and highlights the need for new ways to share research and development costs and understand how value is distributed. As a result, impact first investors may have an especially important role to play in supporting this type of initiative.

What's Required for These Initiatives to Succeed

As a reminder, here is what will be required for these initiatives to accelerate impact investing.

What type of CAPITALIZATION is required?	Operating alone	Small groups of individuals or institutions	Industry level coordination
Subsidy (philanthropy, government, corporate social responsibility)	**N.** Integrate social and environmental factors into economic and finance theory **P.** Support effective and scalable management capacity development approaches for entrepreneurs	**F.** Support the development of backable fund managers	**H.** **Set industry standards for social measurement** **I.** **Lobby for specific policy/ regulatory change** **J.** **Develop an impact investing network** **L.** Coordinate development of a common language platform **O.** Launch a targeted public relations campaign to promote demonstrated successes
Medium-term development funding	**C.** Launch and grow dedicated impact investment banking capabilities **K.** Develop risk assessment tools	**E.** Create investment clubs focused on specific themes **Q.** Provide tools to support research and development for innovative, scalable models	**M.** Create publicly available comprehensive benchmarking data
Short-term profit	**G.** Create financial products to increase accessibility	**A.** **Create industry-defining funds that can serve as beacons for how to address social or environmental issues** **B.** **Place substantial, risk-taking capital into catalytic finance structures** **D.** "Pull" existing intermediaries into impact investing by making business investments	

What level of COORDINATION is required?

Note: Bold indicates a priority initiative.

"Great leaders are identified by their ability to perceive the nature of the game and the rules by which it is played as they are playing it. In other words, the act of sense making is discovering the new terrain as you are inventing it."

—Brian Arthur

CREDITS AND SOURCES

One of our major arguments is that it will take collective effort—not just individual deal-making—to drive impact investing forward. This report is the product of just such a joint effort that spanned most of 2008. The Monitor Institute created the document, and bears full responsibility for its final contents. But we carefully and intentionally engaged many of the pioneers of this emerging industry, taking to heart complexity theorist Brian Arthur's admonition that "the act of sense making is discovering the new terrain as you are inventing it." We want to be clear that no single individual or institution can take credit for the ideas, including its primary authors; they are products of many months of labor by a wide range of people and institutions.

Chief among them are Antony Bugg-Levine and the Rockefeller Foundation, where he is a managing director. Antony was the driving force behind the effort to create this strategy, and Rockefeller provided not only lead financial support but also countless hours of intensive involvement by many of its staff and leaders. This project would not have existed without this vision and support, and we are deeply grateful. We are also indebted to the other funders and supporters that made this work possible: Christa Velasquez of the Annie E. Casey Foundation, Tom Reis of the W.K. Kellogg Foundation, and Kimberly Davis of the JPMorgan Chase Foundation.

The core team that drove this work was led by Katherine Fulton, president of Monitor Institute, and Antony Bugg-Levine of the Rockefeller Foundation. The team included Jackie Khor, Margot Brandenburg, Nina Sen, and Demmy Adesina of the Rockefeller Foundation, as well as Jessica Freireich, Amit Bouri, Andrew Adams, Dhruv Chadha, and Brian Ryoo of Monitor Institute. John Goldstein of Imprint Capital Advisors played an instrumental role in shaping the findings. Jessica Freireich and Katherine Fulton are the report's principal authors; Amit Bouri wrote the profiles, conducted many of the interviews, and contributed additional content.

We also thank the many people who helped shape our thinking or took the time to read and comment on drafts of this report, including Shari Berenbach, John Goldstein, Mike Kubzansky, Christina Leijonhufvud, Lila Preston, Tom Reis, Jason Scott, Christa Velasquez, and Lawrence Wilkinson. Our gratitude is owed to Jenny Johnston of Global Business Network and Gabriel Kasper of Monitor Institute for copyediting, to Ben Morrison of Monitor for shepherding the production process, and to Julie Sherman of J Sherman Studio LLC for the design. We also extend our thanks to Pilar Palacia and her team at the Rockefeller Bellagio Conference Center who helped organize two landmark meetings in which many of these ideas were developed.

This report draws upon a broad range of perspectives, gleaned from primary and secondary research, about investing for social and environmental impact. It builds upon the pioneering thinking of a number of people who have been deeply engaged in this work for years, prominent among them Jed Emerson. Interviews with more than 50 investors and thought leaders about their experiences to date and their perspectives on the future of the industry were essential in shaping our thinking. A wide and varied set of reports, publications, and websites also helped inform our understanding of impact investing and its context. The details about these sources are listed on the following pages.

Interviews and Dialogues in 2008

This core team drew upon the experiences and perspectives of investors and thought leaders who were generous enough to share their time in individual interviews and/or group dialogues at a convening hosted by the Rockefeller Foundation in Bellagio in 2008. Those people, who are listed by their affiliation at the time we met with them, include:

- Michael "Kipp" Baratoff, Equilibrium Capital Group
- Shari Berenbach, Calvert Foundation
- Elliot Berger, Merrill Lynch
- David Blood, Generation Investment Management
- Thomas Brenninkmeijer, Good Energies
- Carol Browner, The Albright Group
- Scott Budde, TIAA-CREF
- Geoff Burnand, Investing for Good
- Mark Campanale, Social Stock Exchange
- David Chen, Equilibrium Capital Group
- Roy Chen, Grace Financial
- Dan Crisafulli, The Skoll Foundation
- Stuart Davidson, Labrador Ventures
- Stephen DeBerry, Kapor Enterprises
- Sally Dungan, Tufts University Endowment
- Toby Eccles, Social Finance
- Christopher Egerton-Warburton, RMB International
- Jed Emerson, Uhuru Capital Management
- Leonard English, General Board of Pension and Health Benefits of the United Methodist Church
- Andreas Ernst, UBS
- Charles Ewald, New Island Capital
- Chris Foy, Aquifer
- Tim Freundlich, Calvert Foundation
- Alex Friedman, Bill & Melinda Gates Foundation
- Michael Froman, Citigroup
- Jay Coen Gilbert, B Lab
- Tsega Gebreyes, Satya Capital
- John Goldstein, Imprint Capital Advisors
- Puneet Gupta, IFMR Trust
- Kyle Johnson, Cambridge Associates
- Kurt Hoffman, Shell Foundation
- Mitch Kapor, Kapor Enterprises
- Andrew Kassoy, B Lab
- Charles Kleissner, KL Felicitas Foundation
- Lisa Kleissner, KL Felicitas Foundation
- Dr. Ivo Knoepfel, onValues
- Kibby Kirithi, Ashbhu Securities
- Cécile Koller, responsAbility
- Bonnie Landers, Sterling Group
- George Latham, Henderson Global Investors
- Jussi Laurimaa, Ibru & Co.
- Christina Leijonhufvud, JPMorgan Chase
- Dan Letendre, Merrill Lynch
- Per Emil Lindoe, Norfund
- Steve Lydenberg, Domini Social Investments
- Josh Mailman, Sirius Change Investments
- JonCarlo Mark, CalPERS
- Maximillian Martin, UBS
- Raphael Martin, RMB International
- Caroline Mason, Investing for Good
- Craig Metrick, Mercer Investment Consulting
- Mike Mohr, Comprehensive Financial Management
- Nachiket Mor, ICICI Foundation for Inclusive Growth
- Stephen Nairne, Lundin for Africa
- Nick O'Donohoe, JPMorgan Chase
- Jeremy Oades, Helvetica
- John Otterlei, F.B. Heron Foundation
- Preston Pinkett, Prudential Financial
- Raul Pomares, Guggenheim Partners
- Lila Preston, Generation Investment Management
- Luther Ragin, F.B. Heron Foundation
- Vineet Rai, Aavishkaar International/Intellecap
- Tom Reis, W.K. Kellogg Foundation
- Álvaro Rodríguez Arregui, IGNIA Partners
- Bas Ruter, Triodos Bank
- Steve Schueth, First Affirmative Financial Network
- Jason Scott, EKO Asset Management Partners
- Wayne Silby, Calvert Group
- John Simon, Overseas Private Investment Corporation
- Henrik Skovby, Dalberg Global Development Advisors
- Cindy Song, Habitat for Humanity International
- Mitchell Strauss, Overseas Private Investment Corporation
- Raj Thamotheram, AXA Investment Managers
- Eva Thörnelöf, Mistra Foundation
- Brian Trelstad, Acumen Fund
- Hubertus van der Vaart, Small Enterprise Assistance Funds
- E. Tyler Van Gundy, Forsyth Street Advisors
- Richenda Van Leeuwen, Good Energies
- Christa Velasquez, The Annie E. Casey Foundation
- Marilou von Golstein Brouwers, Triodos Bank
- Peter Wheeler, IPVALUE/New Philanthropy Capital
- Josh Wolf-Powers, Blue Wolf Capital Management
- Chris Wolfe, Merrill Lynch
- Yuk Lynn Woo, Woo Family Foundation/Central Fabrics
- Ion Yadigaroglu, Capricorn Management
- David Zellner, General Board of Pension and Health Benefits of the United Methodist Church

Literature

There is an emerging body of literature that addresses some part of impact investing. But because investing for impact has not yet come into its own identity as a coherent industry, the scope of this literature is quite diverse and much of it is focused on a specific sector or topic, such as microfinance or mission-related investing by foundations.

In developing this report, we reviewed a broad set of writings in articles, blogs, reports, and books. The following selection provides a flavor of some of the different perspectives.

BlendedValue.org. A repository of publications focused on the thinking and writing of Jed Emerson, who coined the phrase "blended value" to describe an integrated approach to taking economic, social, and environmental value into account. The website includes the Blended Value Map, an early effort to describe the constellation of institutions and structures at play in this diverse field. (www.blendedvalue.org)

Blended Value Investing: Capital Opportunities for Social and Environmental Impact, Jed Emerson and Joshua Spitzer, World Economic Forum, 2006. Describes specific deal structures being pioneered in impact investing, with an emphasis on microfinance innovation, and case studies that outline the leadership that brought specific deals together. (www.blendedvalue.org/media/pdf-blendedvalue.pdf)

Compounding Impact: Mission Investing by U.S. Foundations, FSG Social Impact Advisors, Sarah Cooch & Mark Kramer, 2007. A report based on a study of 92 foundations that engage in mission investing. In addition to proposing a definition for the space, the report provides an assessment of current trends and constraints on future growth and includes frequently cited data on the growth in impact investment by U.S.-based private foundations. (www.fsg-impact.org/app/content/actions/item/182)

Crossing the Chasm, Geoffrey Moore, Collins Business, 2002. A book that discusses the factors that lead from early market success to mainstream market leadership.

Crossing the River and Interpreting Sustainable Development for Financial Markets, Mike Tyrell and Meg Brown, Citigroup Smith Barney, 2005. A research note on trends in socially responsible investment and a methodology for valuing the sustainability performance of companies.

Crossing the River II, Mike Tyrell and Meg Brown, Citigroup Smith Barney, 2007. A follow-up report that discusses the latest thinking on socially responsible investment and its relevance to investment analysis.

Expanding Philanthropy: Mission-Related Investing at the F.B. Heron Foundation, Southern New Hampshire University School of Community Economic Development, 2007. A case study outlining how the Heron Foundation, an early flag-bearer in the move to muster capital from private foundations for impact investment, developed its mission-related investing program and how it manages its portfolio. (www.cof.org/files/images/ExecEd/snhuheroncasestudy.pdf)

From Fragmentation to Function, Jed Emerson and Joshua Spitzer, Skoll Center for Social Entrepreneurship, Said Business School, 2007. A paper that discusses the emerging social capital markets and provides a set of recommendations for improving their effectiveness. (www.blendedvalue.org/media/pdf-capital-markets-fragmentation.pdf)

Just Another Emperor? The Myths and Realities of Philanthrocapitalism, Michael Edwards, Demos/Young Foundation, 2008. An examination and critique of the increasing incorporation of business practices in nonprofits and the use of market-based solutions to address social problems, this brief book sparked a heated debate. In addition to arguing that these efforts fall short of their expected social impact, the book offers recommendations for how business models could be effectively utilized for social benefit. (www.justanotheremperor.org/edwards_WEB.pdf)

Microfinance Banana Skins 2008: Risk in a Booming Industry, Center for the Study of Financial Innovation, 2008. An international survey of 305 microfinance stakeholders that explores concerns for the sector, the relative significance of potential risks, and the preparedness of microfinance institutions to address those risks. (www.citigroup.com/citi/microfinance/data/news081022a1.pdf)

Mission-Related Investing: Philanthropy's New Passing Gear—A Policy and Implementation Guide for Foundation Trustees, Rockefeller Philanthropy Advisors, 2008. A practical guide aimed at the trustees and managers of U.S. private foundations and wealth advisors that describes how to develop and implement a mission-related investing program. The guide addresses topics such as connecting philanthropic and investment strategies, developing a deal pipeline, and measuring impact. The guide includes case studies of foundations that have engaged in mission-related investing, including the experience of the F.B. Heron Foundation, which funded the monograph. (http://rockpa.org/wp-content/uploads/2008/01/MRI.pdf)

Natural Capitalism: Creating the Next Industrial Revolution, Paul Hawken, Amory Lovins, and L. Hunter Lovins, Back Bay, 2000. A seminal book from some of the pioneers in this arena advocating for an approach to business that incorporates environmental considerations while improving economic performance. (www.natcap.org/sitepages/pid20.php)

Philanthrocapitalism: How the Rich Can Save the World, Matthew Bishop and Michael Green, Bloomsbury Press, 2008. An examination of the emergence of a new generation of philanthropists who are employing private-sector approaches to address social issues with an emphasis on accountability and results. Bishop, a reporter with *The Economist*, coined the phrase "philanthrocapitalist."

Reflections on the Compartamos Initial Public Offering, CGAP, June 2007. An instructive examination of the ethical and practical concerns inherent in the intersection of profit-seeking investment and philanthropic intent. The paper describes the landmark initial public offering in early 2007 of the Mexican microfinance institution, Compartamos, and provides a systematic framework for assessing how effectively philanthropic and profit-seeking investment capital achieved their diverse goals. (www.microcreditsummit.org/enews/2007-07_CGAP%20Reflections%20on%20the%20Compartamos%20IPO_42.pdf)

Role Reversal: Are Public Development Institutions Crowding Out Private Investment in Microfinance? Julie Abrams and Damian von Stauffenberg, 2007. This article set off a minor storm in the microfinance community by calling for a more thoughtful examination of the potentially destructive role that subsidized capital can play in undermining the development of local capital markets. While the paper focuses on microfinance, its implications are applicable to impact investing more broadly. (www.microrate.com)

Social Investing 2007, Kyle Johnson, Cambridge Associates LLC. The report combines a conceptual model for thinking about social investing as well as a guide for developing a social investing program.

The Social Investment Bank, U.K. Commission on Unclaimed Assets, 2007. These findings of a government panel articulate the need for impact investment banking services to address the inefficiencies in current charity-based funding mechanisms for delivering social services. Although focused on the U.K. market, the insights and recommendations are relevant in other countries (and are already being acted upon by entrepreneurial initiatives in multiple markets). (www.unclaimedassets.org.uk/downloads/CUA_report_FINAL.pdf)

Socially Responsible Investing, Paul Hawken, The Natural Capital Institute, 2004. A report based on a research project that offers a broad-based critique of the socially responsible investing fund industry, arguing that it hasn't made much of a difference. (www.responsibleinvesting.org/database/dokuman/SRI%20Report%2010-04_word.pdf)

Thematic Research Highlights, Generation Investment Management, 2007. A synopsis of research on several global themes that Generation believes may have material significance for investment performance. (www.generationim.com/media/pdf-generation-thematic-research-v13.pdf)

2007 Report on Socially Responsible Investing Trends in the United States, Social Investment Forum, 2008. A broad overview of the current market for and trends in socially responsible investing, including widely referenced market size estimates that claim more than 10 percent of all professionally managed funds in the United States are held in responsible investment products. (www.socialinvest.org/pdf/SRI_Trends_ExecSummary_2007.pdf)

In addition to the emerging collection of publications focused on impact investing, a number of blogs have been created to discuss related activities and issues. While none are solely focused on impact investing as defined in this document, there are several blogs that address impact investing among other topics. Below, we outline a smattering of these blogs. Given that blogs evolve over time, these sources may shift in their focus after this report is published.

CleanTech Investing (cleantechinvesting.greentechmedia.com). One of several blogs hosted by Green Media, CleanTech Investing provides weekly summaries of deals and discussions of important trends in clean technology.

Creative Capitalism (creativecapitalismblog.com). This blog was launched after Bill Gates gave a high-profile speech on creative applications of capitalism to address social and environmental problems. The blog is primarily focused on the role of corporations, but also tackles impact investing and the role of public policy in providing incentives.

Microcapital (www.microcapital.org). Hosted by MicroCapital, this blog covers international microfinance issues, including impact investments made in microfinance.

NextBillion.net (www.nextbillion.net). A website and blog created by the World Resources Institute and Acumen Fund that seek to promote business efforts aimed at improving the quality of life for poor producers and consumers at the "bottom of the pyramid."

Xigi.net Blog (www.xigi.net). This blog covers a variety of topics such as impact investing, social enterprise, and philanthropy. Within impact investing it frequently has postings about new funds, emerging trends, and investment deals.

Endnotes

1. For an explanation of the market sizing assumptions, please see "How Big Is Impact Investing" box on page 9 and the next endnote.
2. Estimating the current or potential size of the impact investing market is challenging. Because impact investing is not yet a widely recognized definition, there is no secondary data on the overall market. We were unable to aggregate the size of the market from the activities of specific investors and funds because there is not yet sufficient transparency in this emergent industry. Moreover, the definition requires that investors have an intention to have a positive social and/or environmental impact. While there is data estimating the size of sectors that include impact investing such as clean technology, community development, and microfinance, there is no way to accurately estimate the portion of investment activity in those sectors that is driven by an intention to have a positive impact. There are many other sectors of impact investing for which it was challenging to find robust data (e.g., sustainable agriculture). For these reasons, we have outlined the size of certain sectors to provide an indication of the magnitude of impact investing, while recognizing the limitations of this data. In addition, given the significant uncertainty in the global financial markets we used current data on global assets—rather than speculative projections about the size of global assets in five to 10 years—to provide an order of magnitude estimate of the potential future market size of impact investing. Sources for the "How Big Is Impact Investing" box: Community investing is from *2007 Report on Socially Responsible Investing Trends in the United States*, Social Investment Forum (published in 2008); microfinance figures are from *Microfinance: An Emerging Investment Opportunity, Deutsche Bank Research* (published in 2007); clean technology figures are from New Energy Finance referenced in *Clean Energy Trends 2008*, Clean Edge (published in 2008). Philanthropy figures are from *Giving USA 2008* (published in 2008). Social screening and shareholder advocacy figures are from *2007 Report on Socially Responsible Investing Trends in the United States*, Social Investment Forum (published in 2008) and *European SRI Study 2008,* European Sustainable Investment Forum (published in 2008). The global managed assets figure is 2007 data from *Fund Management 2008*, International Financing Services London, reduced by about 30 percent based on estimated decline in global assets as of the end of 2008.
3. The name "impact investing" was first coined by investors who participated in a convening held by the Rockefeller Foundation in 2007.
4. This archetype of industry evolution was influenced by Michael Porter's seminal work, *Competitive Strategy*, The Free Press, 1980, Chapter 8.
5. See *Competitive Strategy*, p. 5.
6. See www.csrwire.com.
7. World Business Council for Sustainable Development and SNV Netherlands Development Corporation, www.inclusivebusiness.org.
8. Nicolas Kraussa and Ingo Walter, "Can Microfinance Reduce Portfolio Volatility?" New York University Finance Working Papers, http://archive.nyu.edu/handle/2451/27406.
9. United Nations Millennium Project, "A Practical Plan to Achieve the Millennium Development Goals," 2005.
10. Compartamos IRR figure is from Richard Rosenberg, "CGAP Reflections on the Compartamos Initial Public Offering: A Case Study of Microfinance Interest Rates and Profits," June 2007, p. 4. Return on equity figure is from The MIX Market, www.themix.org.
11. Monitor Inclusive Markets study of "Market-Based Solutions to Social Change in India," 2008. www.mim.monitor.com.
12. Ibid.
13. Ibid. Based on research and interviews, scale was defined as selling to 1 million consumers; at this point, the marginal cost of adding a consumer is low.
14. Gail Buyske, "The Microfinance Rating Market Outlook: The Rating Fund Market Survey 2006," CGAP.
15. CGAP website, www.cgap.org; SEEP website, www.seepnetwork.org.
16. See www.microcreditsummit.org.
17. Inter-American Development Bank, "IDB Fund, Standard & Poor's to Promote Global Ratings for Microfinance Institutions," press release, February 6, 2008.
18. Deutsche Bank, "Microfinance: An Emerging Investment Opportunity," December 19, 2007.
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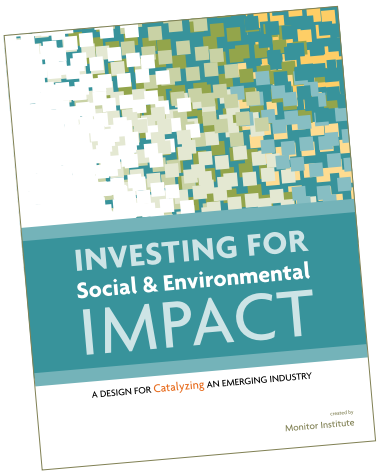
FUNDERS

THE ROCKEFELLER FOUNDATION. The work of the Rockefeller Foundation for the 21st Century is to enable "smart globalization." It attempts to harness the creative forces of globalization to ensure that the tools and technologies that have significantly improved the human condition in many parts of the world during the past half century are accessible today to more people, more fully, in more places. To help foster an enabling environment conducive to the fulfillment of this goal, the Foundation launched a three-year initiative on "Harnessing the Power of Impact Investing" in late 2008. Through this initiative, the Foundation will deploy grants and Program Related Investments, convening power and thought leadership in a three-pronged strategy to help catalyze collective action platforms for impact investors, build intermediation capabilities, and develop investing infrastructure for the impact investing industry globally.

THE ANNIE E. CASEY FOUNDATION. Founded in 1948, the primary mission of the Annie E. Casey Foundation is to foster public policies, human-service reforms, and community supports that more effectively meet the needs of today's vulnerable children and families. In pursuit of this goal, the Foundation makes grants that help states, cities, and neighborhoods fashion more innovative, cost-effective responses to these needs. Grantmaking is limited to initiatives in the United States that have significant potential to demonstrate innovative policy, service delivery, and community supports—especially investments that encourage long-term strategies and partnerships to strengthen families and communities. Social investing is part of a wide range of strategies that the Casey Foundation implements in its effort to improve outcomes for vulnerable children and families. The social investments program uses the Foundation's endowment dollars to generate a financial return and support its investment strategies. Through social investments, the Casey Foundation can increase resources dedicated to its programmatic work and create ways by which the same money can be reinvested over and over again.

W.K. KELLOGG FOUNDATION. The W.K. Kellogg Foundation supports children, families, and communities as they strengthen and create conditions that propel vulnerable children to achieve success as individuals and as contributors to the larger community and society. The Foundation has earmarked $100 million of its endowment assets for a pilot program in mission-driven investing with assets invested in a way that realizes both financial and social returns. Of the $100 million, $25 million has been designated to mission-driven investments in southern Africa, while the balance—$75 million—will be used for investments in the United States. The goal of the Kellogg Foundation's mission-driven investment program is to understand how to better leverage the Foundation's assets for mission purposes. It hopes to recycle capital and preserve its endowment while driving mission impact and potentially extend upon this initial effort.

JPMORGAN CHASE FOUNDATION. JPMorgan Chase's philanthropic goal is simple: be the catalyst to meaningful, positive, and sustainable change within our highest need neighborhoods and communities across the globe. In 2007, JPMorgan Chase gave more than $100 million through grants and sponsorships to thousands of not-for-profit organizations around the world. The Foundation also supports the individual interests of employees through the Matching Gift and volunteer programs. J.P. Morgan launched a social sector finance unit in its investment bank in 2007. The unit leverages the company's products and skills to help bring financial services to microfinance and social enterprises around the world. The scope includes capital markets, structured products, and principal investments. The unit seeks to achieve a double bottom line of social benefit and financial returns.



What's in this Report

A growing group of investors around the world is seeking to make investments that generate social and environmental value as well as financial return. This emerging industry of impact investing has the potential to become a potent force for addressing global challenges. But how might it succeed or fail? Will it take the next five to 10 years? 25 years? Or will it not happen at all? And what will it take for the industry to achieve its promise?

This report examines impact investing and how leaders could accelerate the industry's evolution and increase its ultimate impact in the world. It explores how impact investing has emerged and how it might develop, including profiles of a wide range of impact investors. The report also provides a blueprint of initiatives to catalyze the industry. For an electronic copy of this complete report or an executive summary, please see www.monitorinstitute.com/impactinvesting or www.globalimpactinvestingnetwork.org.

A Community in Formation:
GLOBAL IMPACT INVESTING NETWORK

The Global Impact Investing Network (GIIN) will be a platform for leaders of the impact investing industry to address many of the barriers to the industry's development identified in this report. The GIIN is forming as an independent, non-profit membership trade association of impact investors in 2009.

By bringing together the large-scale family offices, institutional investors, pension funds, investment banks, wealth managers, private foundations, and development finance institutions whose goals lie in the territory between philanthropy and the sole focus on profit-maximization, the GIIN aims to drive collectively toward the maturation of an industry that is currently inhibited by fragmentation. The GIIN seeks to add value to its members by publicizing prototypical impact investments, disseminating basic knowledge, developing industry infrastructure, and ultimately connecting impact investors across sectors and geographies through a variety of networking opportunities.

Please visit www.globalimpactinvestingnetwork.org or contact info@impactinvestingnetwork.org for more information on the Network.