PRINCIPLES AND PRACTICE OF IMPACT INVESTING

A Catalytic Revolution

Edited by Veronica Vecchi, Luciano Balbo, Manuela Brusoni and Stefano Caselli

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Foreword

Doug Miller
Founder Chairman of the European Venture Philanthropy Association (EVPA)
Founder Chairman of the Asian Venture Philanthropy Network (AVPN)

It's a real privilege to write this Foreword, as Luciano Balbo has been my friend since 1988 and together with other pioneers in the social impact investing space we founded the European Venture Philanthropy Association (EVPA). Luciano has always been a thought leader and both a thinker and a doer. Recently, Luciano has supported SDA Bocconi, the School of Management of Bocconi University, to launch "The Impact Investing Lab", an initiative aimed at generating and sharing actionable knowledge, through research and executive education, with specific reference to impact investing in mature economies, where new societal needs are emerging also as a consequence of curtailed public budget.

This book has been conceived by the team of SDA Bocconi Impact Investing Lab, gathering together different perspectives and competences: Luciano brings in his perspective and experiences as investor and impact investing leader; Veronica and Manuela, professors at SDA Bocconi, bring in the public policies, public–private partnerships and social innovation dimensions; Stefano, Full Professor at Bocconi University, adds the perspective of financial markets and venture capital.

The term impact investing is not precisely defined, but the general concept has become quite popular. This has been due to the efforts of pioneers of the industry, who have taken theory into practice and have dedicated themselves to promote this new activity. For this reason, I am privileged to have been Founder/Chairman of both EVPA and the Asian Venture Philanthropy Network (AVPN), which have played roles, alongside, of course, Global Impact Investing Network (GIIN), in the development of this nascent investment approach.

With the multitude of social problems existing in every country—both developed and developing—the major issues around poverty, health, education, environment, economic opportunity and social justice are global. Existing solutions need to be executed in a more effective way and new solutions need to be identified. Collaboration across the multitude of different actors also needs to take place, both in an unstructured and structured fashion.

Impact investing is certainly one of the tools that needs to be strongly considered when addressing these challenges. The structures and approaches, however, depend on the individual social sectors and jurisdictions. One of its main advantages is that it is possible, under the right circumstances, to attract both philanthropic and more commercial capital, thereby bringing more resources to the table. However, financial resources will never be enough. We need considerably more human resources as well as the cross-border transfer of intellectual knowledge.

On a personal basis, I see people reinventing the wheel endlessly, and this often results in higher costs and sub-optimal solutions. One of the key wins can be a mixed solution, bridging philanthropy and impact investing, where philanthropy takes more of the early stage and start-up risks and impact investing follows on with scaling and replication. All of this, of course, is easy to say in theory and much harder to do in practice. The pioneers of this industry on both sides of the equation are to be applauded. The market is still small and has yet to show its capacity to propose and implement effective solutions.

A note of caution is that, while great opportunity exists, there is also the opportunity to use the impact investing concept and methods incorrectly: by pushing progress faster than it can actually be made; by not getting the balance between social and financial return correct [obviously a judgment call]; or by promising supporters much more than can really be delivered.

This book represents an important milestone by sharing knowledge, experiences and building awareness about impact investing. I hope it can contribute to a fruitful discussion around the whole industry to foster its development.

Table of abbreviations

ADOA	Additionality and Development Outcomes Assessment
AED	Asociacion de Empresarios para el Desarrollo
AFD	Agence Française de Développement
AfDB	African Development Bank
ANDE	Aspen Network of Development Entrepreneurs
ARCA	Agenzia Regionale Centrale Acquisti
ASFOR	Italian Association for Management Development
AuM	Assets under Management
AVPN	Asian Venture Philanthropy Network
BITC	Business in the Community
BoP	Base of the Economic Pyramid
BPO	business process outsourcing
CA	Cambridge Associates
CAFEF	Conflict-Affected and Fragile Economies Facility
CBE	community-based enterprises
CCD	compulsorily convertible debt
CCPS	compulsorily convertible preference shares
CDFI	Community Development Financial Institutions
CFA	chief financial adviser
CGTMSE	Credit Guarantee Fund Trust for Micro and Small Enterprises
CIFF	Children's Investment Fund Foundation
CIIE	Centre for Innovation Incubation and Entrepreneurship
CIO	Chief Investment Office(r)
CPI	consumer price index
CRM	consumer relationship management
CSR	corporate social responsibility
DFI	development finance institutions
DfID	Department for International Development

DIB	Development Impact Bond
EDI	entrepreneurship development institutions
EFC	European Foundation Centre
EIB	European Investment Bank
EIF	European Investment Fund
EMPEA	Emerging Market Private Equity Association
ESG	environmental, social and governance
EU	European Union
EVCA	European Venture Capital & Private Equity Association
EVPA	European Venture Philanthropy Association
FB	Futurebuilders
FDI	foreign direct investment
FV	financial valuation
FY	fiscal year
GAIC	Gujarat Agro Industries Corporation
GDP	Gross Domestic Product
GIIN	Global Impact Investing Network
GIIRS	Global Impact Investing Rating System
HCT	Hackney Community Transport
HNWI	high-net-worth individual
HSI	high sustainability investments
IDB	Inter-American Development Bank
IFC	International Finance Corporation
IFE	Impact Financing Envelope
II	[please provide definition]
IIC	Impact Investors Council
IIIF	India Inclusive Innovation Fund
IIL	Injaro Investments Limited
IIM	Indian Institutes of Management
IIT	Indian Institutes of Technology
IIX	Impact Investment Exchange
ILO	International Labour Organization
INR	Indian rupee
IPO	initial public offering
IRIS	Impact Reporting and Investment Standards
IRR	internal rate of return
IT	information technology
KPI	key performance indicators
LLC	limited liability corporation
LIBOR	London inter-bank offered rate
LOHAS	lifestyles of health and sustainability
LP	limited partner
MAYA	Movement for Alternatives & Youth Awareness
MDGs	Millennium Development Goals

MFI	Made in the Financial Inclusion
MIS	management information system
MOU	memorandums of understanding
MRI	mission-related investing
MSDF	Michael & Susan Dell Foundation
MSME	Micro, Small & Medium Enterprises
MUDRA	Micro Units Development Refinance Agency
NABARD	National Bank for Agriculture and Rural Development
NASE	National Association of Social Enterprises
NBFC	non-banking financial companies
NCIF	National Community Investment Fund
NEET	not in education, employment or training
NInC	National Innovation Council
NITI	National Institution for Transforming India
NGO	non-governmental organization
NPO	nonprofit organization
NSDC	National Skill Development Corporation
ODA	Official Development Assistance
OTCEI	Over-the-counter Exchange of India
PE	private equity
PPC	public–private collaborations
PPP	public–private partnership
PRI	programme-related investments
PSI	proactive social investments
R&D	research and development
ReM	results measurement
ReM+	enhanced results measurement
RMK	Rashtriya Mahila Kosh
ROI	return on investment
RTBI	Rural Technology and Business Incubator
SAC	Sealed Air Corporation
SBA	Small Business Administration
SBIC	Small Business Investment Company
SDGs	Sustainable Development Goals
SEA	Social Enterprise Alliance
SEBI	Securities Exchange Board of India
SETU	Self-Employment and Talent Utilization
SIA	Social Impact Accelerator
SIB	social impact bond
SIDBI	Small Industries Development Bank of India
SIFI	Social Investment Financial Intermediaries
SII	social impact investment
SITR	Social Investment Tax Relief
SME	Small and medium-sized enterprises

SPI	Social Progress Index
SPO	social-purpose organizations
SRI	socially responsible investing
SROI	social return on investment
SVX	Social Venture Connexion
TA	technical assistance
TEEP	Tony Elumelu Foundation Entrepreneurship Programme
TP	traditional philanthropy
TSO	third sector organization
UNCTAD	United Nations Conference on Trade and Development
UNEP	United Nations Environment Programme
UNICEF	United Nations Children's Rights & Emergency Relief Organization
USAID	United States Agency for Internal Development
VC	venture capital
VP	venture philanthropy
VPO	Venture Philanthropy Organization
WEF	World Economic Forum
WIR	Wirtschaftsring
WISE	work integration social enterprises
WM	wealth management

1

Impact investments

The emergence of a new beacon in investing?

Harry Hummels[1]
Professor Dr of Ethics, Organizations and Society at Maastricht University

A new term is born

The coming together of like-minded spirits

Picture a grand villa at Lake Como in the summer of 2007. Weather conditions do not matter in this tiny part of the world. Whether the sun is out, skies are overcast with clouds, rain is pouring down or virulent storms are knocking at the villa's door, the scenery remains ravishing. The villa is the Villa Serbelloni in the picturesque village of Bellagio on the banks of Lake Como. It once belonged to the Princess Della Torre e Tasso. Currently, the villa is known as the Rockefeller Foundation's Bellagio

1 Professor Dr Harry Hummels holds a chair in Ethics, Organizations and Society at Maastricht University and a chair in Social Entrepreneurship at Utrecht University. This chapter is part of the PROOF Impact project of Maastricht University, made possible by Noaber Foundation. It is partly based on some 70 interviews with pension funds, sovereign wealth funds, insurance companies and asset managers by the author. The author would like to thank Rosemary Addis for her very helpful suggestions to improve this chapter.

Center, a place for international conferences and scholarly and artistic residencies. At one of its events in 2007 the term "impact investing" was coined.[2]

Even though the term was new, the practice it referred to certainly was not. Investors, intending to create positive social or environmental outcomes while generating a financial return, had been around for decades. They simply operated in the margins of the financial system and remained more or less unnoticed. Pioneers such as Accion, Triodos Bank, Acumen, Calvert Foundation, Social Finance, Oikocredit, Microvest, DOEN Foundation and several development finance institutions had been experimenting for more than a decade, if not decades, with new ways to promote social or environmental benefits for the communities they invested in. In 2007 they had built up experience in areas such as renewable energy, microfinance and affordable housing, targeting both financial and extra-financial returns. According to the Monitor Institute the pressing question was, however, whether impact investing would remain "a small, disorganized, underleveraged niche for years or even decades to come" (Freireich & Fulton, 2009, p. 5). Alternatively, the question was whether leaders would come together "to fulfil the industry's clear promise, making the new domain a major complementary force for providing the capital, talent and creativity needed to address pressing social and environmental challenges" (*ibid.*, p. 5).

A major step forward

Several years down the road, the leaders did come together to try to establish an environment in which this force for positive social and environmental change could come to fruition.[3] An important element in this development was the launch of the Global Impact Investing Network (GIIN) in 2009 and the activities of the network ever since. Whether the industry has made much progress, however, is a matter of perspective. If one looks at the supply side it is without doubt that every year more capital has been allocated towards impact investments (see J.P. Morgan & GIIN, 2010, 2011, 2013, 2014, 2015; GIIN, 2016), more funds are offered to interested investors,[4] more networks become actively involved in impact invest-

2 See Harji & Jackson, 2012. The 2007 meeting coined the term and concept of "impact investing" itself, and, in 2008, the Rockefeller Foundation's Board of Trustees approved $38 million towards its new Impact Investing Initiative, which sought to use grants, programme-related investments (PRIs) and non-grant activities to implement the industry-building plans created through the Bellagio convenings.

3 Examples are the G7 summit in 2013 under the presidency of UK Prime Minister David Cameron, in which impact investing was specifically addressed and a special task force was launched. Also at the third UN Financing for Development Conference in Addis Ababa in 2015 notions such as blended finance and impact investing were prominent discussion topics.

4 The GIIN's ImpactBase (www.impactbase.org) is the leading platform that provides an overview of impact investment funds that are currently on offer in the market. In September 2015 the database reported 364 impact investment funds. This is up from 44 in 2010,

ing,[5] more articles and reports are being published, more courses are taught on the subject and so forth. Nevertheless, if the United Nations' (UN) Sustainable Development Goals (SDGs) are the benchmark, the only justifiable conclusion is that impact investing still walks around in nappies and requires a lot of nurturing. The SDGs contain targets to, inter alia, end poverty and hunger, improve health and education, achieve gender equality, increase access to clean water and sanitation, and combat climate change. They are likely to dominate the public discussion on international development in forthcoming years. According to the United Nations Conference on Trade and Development (UNCTAD) World Investment Report 2014 additional funding is needed US$1.6–2.8 trillion annually to achieve SDG objectives.[6] This estimation leaves aside the need for impact investment capital in OECD countries—where a significant part of the current investments are made. According to the UN, governments, international organizations, non-governmental organizations (NGOs) and multinational corporations, the private sector can make an important contribution to fund the need for capital. Theoretically speaking, pension funds, insurance companies and asset managers, with total Assets under Management (AuM) of roughly speaking US$100 trillion, have deep enough pockets to invest in the required development. The Social Impact Investment Task force of the G8 (2014, p. 1) remarks in this respect:

> Given that $45 trillion are in mainstream investment funds that have publicly committed to incorporate environmental, social and governance factors into their investment decisions,[7] it would only need a small fraction of this money to start moving into impact investment for it to expand rapidly along the growth path to the mainstream previously taken by venture capital (VC) and private equity (PE).[8]

This chapter

This contribution describes the development of impact investing. It is a growing and maturing field of investments for various investors with numerous instruments in different asset classes. Section 2 describes impact investing as a crystallization

with a steep rise in 2011 and 2012. ImpactBase shows an average annual growth of some 65 funds per year.

5 Apart from the Global Impact Investing Network (GIIN) I like to mention, inter alia, Toniic, EMPEA, EVPA, ANDE, Socap, Pymwymic and Society Impact.

6 This seems to be a very modest account of what is needed, if one only thinks of the US$1–1.5 trillion that is required for infrastructure investments in the developing world. See United Nations, 2015, p. 6.

7 Here the task force references institutional investors having signed the Principles for Responsible Investment.

8 See OECD, 2014. Whether they have enough assets practically speaking to bridge the gap depends on the investment solutions that are available to them, given their fiduciary responsibility.

point of different initiatives—ranging from socially responsible investments to mission-related investing and to development finance. Impact investing brings together different approaches in a "big tent" and invites asset owners, asset managers and service providers to engage in an open discussion. Section 3 demonstrates that impact investing is a colourful field of contributions from a multitude of investors with different objectives, needs, resources and expectations. With the rapid growth of the market it is not so much the amount of invested capital that is relevant to describe the development of the field; more important are the forces that are driving the growth, while occasionally causing it to slow down again. Section 4, therefore, looks out to the future to shed some light on these driving forces and to the barriers that impact investors face. The underlying thesis of this chapter is that impact investing has the potential to move from individual and more isolated impact investments to more concerted efforts to develop a global market with a large variety of private and public players and a wide range of investment opportunities.

Impact investing as a crystallization point

No *deus ex machina*

The Monitor Institute was one of the first to recognize the opportunity of investing to promote social and environmental good. According to the institute in its *Investing for Social and Environmental Impact* (Freireich & Fulton, 2009), the idea of investing for the common good "is moving from a periphery of activist investors to the core of mainstream financial institutions". Although somewhat overstated at the time,[9] the report described a discernible trend of investing for the common good beyond philanthropists and wealthy individuals or families (Rodin & Brandenburg, 2014, p. 6). The first decennium of this century showed a broader interest in social investing not only from a range of foundations and high-net-worth individuals (HNWI), but also from family offices and private banks. Gradually others such as international and development finance institutions, development organizations and asset managers have picked up the trend too. Institutional investors such as pension funds and insurance companies are still seen as laggards in this field—with a few "notable exceptions" (World Economic Forum, 2013a, p. 13).[10] Let's start this overview with the work that foundations have done in this area.

9 Sparkes (2006, p. 54) observed nearly ten years ago that the financial system still had a long way to go in "a proper alignment of SRI and social activism". I like to echo these words when describing the alignment of impact investing and social activism among mainstream investors.

10 Exceptions come from, among others, PGGM, APG, Christian Super, TIAA CREF, Zürich and Aegon.

The US tax code allows a 501c3 foundation to make investments if these are made in support of the foundation's charitable purpose (IRS, 2015). Usually, these investments are referred to as programme-related investments (PRIs). The Jesse Smith-Noyes Foundation, however, was quite critical about the tiny fraction of its capital that was donated or invested in line with its mission. The foundation, therefore, had already asked itself in the 1990th what to do with the management of the endowment? As a result, it decided to "reduce the dissonance" between the management of the endowment and the philanthropic mission of the organization (Hummels, 2009). Or, put differently, the foundation decided to bridge the "investment gap" (Emerson, 2003, p. 40) between social and financial capital—and it surely was not the only one.[11] The initiative resonated well with US and other foundations across the globe. Mission-related investing (MRI)[12] was soon to become a significant investment activity among a wide range of foundations. Other initiatives followed with more or less the same objectives—be it with different names such as "mission connected investing",[13] "mission investing",[14] "proactive social investments" (PSIs),[15] "program-related investing" and "venture philanthropy".[16]

A second trend that was instrumental in the birth of impact investing was the rise and development of socially responsible investing. Impact investors, however, are ambitious to go beyond traditional "socially responsible investing". Their ambition is to actively place capital in businesses, projects, commodities, cooperatives or financial institutions with an objective to promote environmental or social objectives. Investors are often found among family offices, philanthropic foundations or church communities, but are not restricted to these groups. Development finance institutions, asset managers and a few institutional investors have also become part of the spectrum. Apparently, the investors were sufficiently convinced of the *business case* for integrating social and environmental objectives in creating long-term financial returns and minimizing risk (Margolis & Walsh, 2001;

11 Around the same time that John D. and Catherine T. MacArthur began exploring private investing that deployed a portion of the corpus in support of mission. Investments related to programs (IRPs) were envisioned as investments that would more flexibly deploy assets in pursuit of mission. See Tasch & Dunn, 2001.

12 MRI can best be described as "any investment activity, which seeks to generate a positive social or environmental impact in addition to providing a financial return". See Godeke & Bauer, 2008, p. 11.

13 With mission-connected investing NEF means "investment from the foundation's endowment which furthers its mission and provides returns at market levels". Cf. NEF, 2008.

14 Cooch & Kramer justify their preference for "mission investing"—which they describe as "the practice of using financial tools to achieve a foundation's mission"—instead of the widely used "mission-related investing" since the latter (too) often refers to investments with a market-rate return (cf. Cooch & Kramer, 2007, p. 10).

15 "PSIs provide direct financing to create or expand enterprises that deliver social or environmental benefits in furtherance of the investor's programmatic goals." See Kramer & Cooch, 2007.

16 Cf. Chapter 7 in this book.

Gompers *et al.*, 2003; Orlitzky *et al.*, 2003; Statman, 2000, 2006; Derwall *et al.*, 2005; Garz & Volk, 2007; Hill *et al.*, 2007; UNEP FI, 2006, 2010, 2011; Bauer & Hummels, 2010). A case in point that particularly attracted the attention of institutional investors was the 2007 initial public offering (IPO) of Mexican microfinance institution Banco Compartamos. The IPO suggested—at least in the short term—that providing access to finance to poor people could lead to highly competitive market-rate financial returns. As a result the flow of private investments to the microfinance market increased significantly—from US$1 billion in 2005 to US$8 billion reported in 2013 (Microrate, 2013). Asset managers and private banks found their way to microfinance institutions through investment funds targeting foundations, NHWIs and retail clients. Some such as responsAbility and ACTIAM targeted the institutional investment market, raising hundreds of millions of dollars for microfinance investments and small and medium-sized enterprise (SME) finance. Initiatives in the area of microfinance and SME finance have gradually triggered interest from institutional investors—although institutional investors, perhaps with a few exceptions, still have significant difficulties in catching up with this development.

A third impetus came from development finance institutions (DFIs) and multilateral development banks. They had been investing in international development for decades, implicitly combining (market-rate) financial returns and social, economic or environmental objectives—most notably in generating economic growth in developing countries. According to a study of the International Finance Corporation (IFC) (2011) the social and economic development perspective of the DFIs has always led to the creation of positive impact on private sector development. The private sector arm of the World Bank revealed that international finance institutions invest an impressive US$40 billion per annum in developing countries in private sector development and infrastructure (*ibid.*, p. 21).

Defining impact investing

When the Rockefeller Foundation organized the Lake Como summits in 2007 and 2008, the emergence of impact investing out of the already well-established practices of mission-related investments, socially responsible investments and development finance was only a natural next step (Bugg-Levine & Emerson, 2011, p. 8). Impact investing thereby took the existing approaches to a higher level—and facilitated the emergence of an expanding and potentially global market for enhancing the public good. It consistently and systematically focused on realizing financial and extra-financial objectives in parallel—which captured Porter & Kramer's (2011) idea of creating shared value as referred to by Vecchi *et al.* (see Chapter 4). In line with this concept impact investing could be described as: **the entire spectrum of investments aiming to create shared value**. By definition, this notion comprises financial and social or environmental outputs and outcomes. This same spirit was captured in Monitor Institute's (Freireich & Fulton, 2009) rather generic definition of impact investing as: "Actively placing capital in businesses and funds that

generate social and/or environmental good and at least return nominal principal to the investor."

Many definitions were to follow (Bugg-Levine & Emerson, 2011; Grabenwarter & Liechtenstein, 2011; Harji & Jackson, 2012; World Economic Forum, 2013; Addis *et al.*, 2013; Social Impact Investment Task force, 2014; Rodin & Brandenburg, 2014). One of the most prominent definitions comes from the GIIN describing impact investments as: "**Investments made into companies, organizations, and funds with the intention to generate social and environmental impact alongside a financial return**."[17]

This definition implies that impact investors meet at least the following three criteria. They:

1. Have an **intention** to create extra-financial impact before the investment is actually made
2. Have a **financial return** expectation, which can range from market rate to below-market rate returns; the minimum requirement is the preservation of capital[18]
3. Take initiatives to create, manage and **measure** social, economic and environmental impact[19]

There is a notable exception to the bulk of impact investing definitions, which deserves mentioning here. Lewin (2013, p. 10) takes the perspective of an institutional investor when he remarks: "To generate a much more targeted, direct and potentially measurable outcome, but without compromising financial success: this is our definition of impact investing."

This definition points to two important characteristics for institutional investors. First, investments are relevant only if they lead to (risk-adjusted) returns in line with—at least—the average performance of the assets class. Second, Lewin puts emphasis on the need to generate targeted outcomes. Apart from being able potentially to measure the (extra-financial) outcomes the definition implicitly stresses the importance of managing the relevant processes to ensure the achievement of the targeted outcomes. Impact management, therefore, is of great importance to investors. Impact measurement is relevant to the extent that it monitors progress on the stated objectives and provides information on intended and non-intended outputs and outcomes. More generally, Lewin's point makes clear that different

17 https://thegiin.org/impact-investing/need-to-know/#s1

18 Below the level of capital preservation or revolving investments, providing capital becomes grant making.

19 I have taken the liberty of adding the focus on managing extra-financial results. Measurement is important, but not an end in itself. More important than measurement (sic) is the value of information in managing the investment so that optimal financial and extra-financial returns are created and risks involved are managed.

investors may have different motives for entering the field of impact investing and different requirements depending on the nature of the investment.

Impact investing further explained

A promising company

Ecovative Design LLC is a young materials science company from Green Island (NY) that grows materials made from mushroom mycelium. It harnesses the power of nature to replace and eliminate the pollution generated across the petroleum-based plastics supply chain, such as highly polluting Styrofoam. In 2010 DOEN Foundation was the first to provide growth-stage capital to finance the company's expansion. DOEN's initial investment was followed by additional investments totalling some US$2.5 million, providing a solid basis for attracting additional capital from private and corporate investors. Among those were two companies: 3M and Sealed Air Corporation (SAC) (Hummels & Röntgen, 2013). With its investment DOEN Foundation opened up a new world for Ecovative Design to grow its business and help to reduce the pollution of the earth and the seas. The stakes were high, and so were the ambitions. Petroleum-based plastics are a major cause of the plastic soup and offering packaging alternatives that were fully biodegradable was revolutionary. At the same time Ecovative Design has the potential of becoming a great business and the adoption of its solutions by 3M and SAC is already proof of this. Now the question comes up whether more mainstream investors could have stepped in and seized the opportunity? The answer is no. To understand this, one has to look at six characteristics that clearly mark the differences between investors when creating a positive impact for society. These will be discussed in the next section.

Dimensions

Impact investors vary significantly in their objectives, practices and capital allocations. Three dimensions can be distinguished that will be discussed in the remainder of this chapter:

1. Investors and investment regions
   - Different impact investing communities
   - Allocations across geographies
2. The investment market
   - Size of the market and of the investments
   - Investments across asset classes

3. Returns
   - Differences in financial return expectations
   - Measuring and managing outputs and outcomes

As will be shown, these dimensions picture the current impact investment sector as a colourful and emerging universe of diverging contributions.

Investors and their investment regions

DOEN Foundation (Hummels & Röntgen, 2013) took a clear risk when it decided to invest in Ecovative Design. Investing in the company may have been in line with its mandate "to demonstrate that it is possible to achieve both social and financial returns" but, at the same time, by making the investment it provided the company with an opportunity to further develop its business thesis, its product portfolio and its presence in the market—and setting the stage for growth capital to come in. Clearly, to invest in a start-up such as Ecovative Design is not every investor's cup of investment tea. For some the investment is too small; others may think it is too risky or find the management too inexperienced. Some particularly like that the company operates in an OECD country; for others this is precisely a reason not to give it any priority.

In order to develop the impact investing field and enable companies such as Ecovative Design to thrive, investors do not require similar investment philosophies, objectives or practices. It would be a mistake to think of investors as belonging to one big impact investing community,[20] although they may belong to sub-communities of similar and like-minded organizations. Institutional investors may share similar impact investment beliefs, objectives and practices with other institutional investors, foundations with other foundations, family offices with other family offices, DFIs with other DFIs and so forth. Although one may find significant resemblances between investors within their sub-communities, significant differences will remain across regions, investor type and investment philosophy—with clear differences in mission, responsibilities and modus operandi. That means that **pluralism** is a fundamental characteristic of the actors in the field of impact investing.

Obviously, at the overarching level of relevant networks such as PRI, GIIN, European Venture Philanthropy Association (EVPA) or Toniic, investors share rather generic objectives, learn from each other and collaborate. There may be common ground in diversity, providing a basis for cooperation on some shared objectives—but also the need to share costs, knowledge or networks. In order for the field to grow, collaboration between investors is therefore necessary.[21] One investor's exit is

20 I take a somewhat different view to Rodin & Brandenburg (2014, p. 15).

21 Quite often collaboration is also required between investors and other relevant stakeholders, such as businesses, governments, NGOs and sometimes academics, to turn an investment into a success.

another investor's investment opportunity.[22] At best this results in (temporary) **coalitions**. Coalition building does not restrict itself to investors. In order for impact investing to thrive, efforts are required to bring together investors, governments, philanthropic organizations and civil society. There needs to be a virtuous circle between public and private undertakings to create new opportunities, share costs, maximize impact and ensure inclusive growth. If investors are willing to contribute to resolving or reducing public challenges in providing access to basic goods and services such as (sustainable) energy, water, food, health care, education, finance or affordable housing, they have to work together with social and environmental stakeholders—both public and private. As Dichter (2014) remarks:

> The future of impact investing depends on our ability to embrace what we've learned over the course of economic history: solving social issues requires both private and public capital [...] Hospitals, parks, educational systems, sanitation infrastructure, low-income housing—globally, risk-seeking investors build these solutions in partnership with the public sector, which plays its part to adjust incentives, act as a major customer, and provide subsidy where needed.

Allocations across geographies

With a few exceptions for investments in microfinance, SME finance or renewable energy institutional investors have a clear preference for investing in developed countries. DFIs, IFIs and some ministries of development cooperation, on the other hand, explicitly target developing countries. Depending on their mission and philosophy foundations, wealthy individuals and family offices vary in their impact investing approaches. Some have a domestic orientation, such as Big Society Capital and the Esmée Fairbairn Foundation in the UK or the Nonprofit Finance Fund and the National Community Investment Fund (NCIF) in the US. Some others have a clear regional orientation, such as the Inter-American Development Bank, the African Development Bank (AfDB) or the Asian Development Bank. Again others have a broad international perspective. Examples come from the Bill & Melinda Gates Foundation, Anthos Asset Management, ACTIAM and LGT Venture Philanthropy. Finally, there are impact investors such as Noaber Foundation, Calvert Foundation, Rockefeller Foundation or Ford Foundation that are more agnostic about the region in which they invest. They can have both a domestic and an international focus. Recent research by J.P. Morgan & GIIN (2010, 2011, 2013, 2014, 2015; GIIN, 2016) provides an indication of the amount of impact investments in developing regions.[23] These studies provide a relevant benchmark to assess the

22 EVPA, CGAP, Accion and the GIIN took relevant initiatives in this respect. See Boiardi & Hehenberger, 2014; Rozas *et al.*, 2014.

23 The studies do not yet include information on the potential of a recent development in impact investing—diaspora finance. Communities living in exile often have a significant desire and inclination to contribute to developments in their home countries.

Table 1.1 **Estimates about current and future impact investing markets**

Source: Kepler Cheuvreux, 2013, p. 26

Source	Amount	Focus	Date of estimate publication	Details
Estimates of the current market				
WEF, Deloitte	<US$40 billion	Global	2013	Cumulative capital committed
WEF, Deloitte	US$25 billion	Global	2012	Conservative market size based on CGAP's estimates of microfinance and financial services as well as JP Morgan and GIIN's estimates
GIIN, JP Morgan	US$9 billion	Global	2013	Planned commitments for 2013
GIIN, JP Morgan	US$8 billion	Global	2013	Capital committed in 2012
Eurosif	€8.75 billion	Europe	2012	Invested assets (excl. commitments)
Market forecasts				
Calvert Foundation	US$650 billion	Global	2012	Market potential
JP Morgan, Rockefeller Foundation	US$400 billion–US$1 trillion	Global	2010	Market potential by 2020, based on estimates of the BoP market potential across five sectors
Monitor Institute	US$500 billion	Global	2009	Market potential by 2020 (total managed assets)

development over time of impact investing in developing countries and in specific assets classes—ranging from private equity to private debt and real assets.[24]

Investment markets

In comparison with the estimated need for investments that contribute to social and environmental change, as reported in the UNCTAD study, the gap with actual impact investments is enormous. Indications about the size of the impact investing market vary significantly. Table 1.1 provides an indicative overview of different accounts of the market—some prospective, others retrospective. The overview comes from a Kepler Cheuvreux (2013, p. 29) market study.

Despite the recent financial crisis the financial markets are growing at a staggering pace. Institutional investors play an important role in this growth. Current estimates of the global asset market vary between US$64 trillion and US$200 trillion (cf. PwC, 2014; Baghai *et al.*, 2015). With assets under management (AuM) of nearly

24 In the broader spectrum of this chapter it will be relevant to see if and to what extent institutional investors will ultimately be prepared to allocate investment capital to developing countries.

US$37 trillion and US$22 trillion, pension funds and insurance companies are very significant players in the global financial markets (Towers Watson, 2015; PwC, 2014; PwC, 2014; TheCityUK, 2012). The mastodons, however, are slow to adapt to the changing impact investing environment (Social Finance, 2012; Harji & Jackson, 2012, World Economic Forum, 2013a, p. 21). Institutional investors have quite a few excuses not to allocate capital to impact investing solutions. The ten most common explanations—or excuses—not to invest are seen in Box 1.1.[25]

Box 1.1 **Ten reasons not to invest in impact investments**

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1. *The ecosystem is still early stage*. According to 86 percent of US-based pension funds surveyed, the market seems to be a niche—early stage and immature.
2. *The average deal size is too small.* Leading pension funds and insurance companies require a minimum investment size of US$50 to 100 million per investment—and some even more substantial. Their investment may usually not exceed 25 percent of the total proposition. Therefore and on average, the size of the total capital investment easily exceeds US$300 million. Only a limited number of impact funds is able to match this requirement.
3. *Solvency II, AIFMD and Basel III require increased capital reserves from institutional investors.* Impact investments are seen as alternative, risky and illiquid investments by supervisory authorities. As a result of new rules and regulations the capital charge on illiquid and risky investments require institutional investors to increase their financial reserves.
4. *Institutional investors require investment grade products with a proven track record.* Only a small minority of investment propositions have a proven track record and can demonstrate that they are investment grade.
5. *Risks are perceived as too high*. Impact investments are perceived as risky—in terms of financial risk, operational, managerial, or reputation risk. Although the perception may be incorrect, it is prevalent among institutional investors. The perception of risk increases if investments are made in non-OECD countries (country risk, currency risk, political risk, and corruption risk). As one fund explained: “Investments in Africa are a near no-go”.
6. *Impact investments may lead to conflict with the investor’s fiduciary responsibility*. Investors, particularly in the US, refer to their fiduciary responsibility as an explanation for not allocating capital to impact investments. Often this ‘fiduciary responsibility’ is synonymous for targeting maximum returns—and impact investing is believed to lead to concessionary returns.
7. *Looking for standard products.* Institutional investors require standardized products along the lines of established and well-recognized asset classes.

25 These reasons were given in the interviews with some 70 institutional investors conducted as part of the research contributing to this chapter. In addition, many of the arguments can be found in Social Finance (2012), The Smith Institute (2012), Harji & Jackson (2012), World Economic Forum (2013a) and Addis *et al.* (2013).

Impact investments, however, do not always have a clear private debt, private equity, real estate or infrastructure character—let alone public equity or public debt.

8. *Having doubts about the size, appropriateness and quality of the project pipeline.* Insurance companies have an appetite for large-scale private debt; pension funds prefer private equity, infrastructure, and real estate. Investment opportunities in these areas are relatively scarce; those that are available not always have the right maturity. So, while project developers are looking for early stage capital to finance design, development or construction of a project, investors focus on reinvestment opportunities. They require stable and long-term flows of income to match long-term liabilities.
9. *Looking for lower management fees*. Investors expect to receive adequate and relevant information in time on (social and environmental) progress of the investment. Developing and processing information costs time and money, which has an effect on (increasing) fees. Institutional investors currently focus on reducing management fees.
10. *Returns are not attractive compared to alternative investment opportunities.* Investors may ignore an investment because other investment opportunities generate higher returns. In a market with average returns of 8% an investment with a positive impact may falter when comparable, alternative investments generate 10% in the same period.

Considering the magnitude of some of the social and environmental issues our society is facing, the importance of institutions contributing to resolving societal needs cannot easily be overestimated. Trillions of dollars are needed annually in infrastructure investments—not to mention the additional capital needed elsewhere. This means that the excuses given by institutional investors not to invest in the emerging field of impact investing provide important guidance for the existing players—such as foundations, private banks, multilateral donors, governments—to focus their efforts. Only when these potential barriers are overcome, can the market grow at a pace and a scale that is required to start resolving some of the most pressing issues in areas such as energy production and distribution, solid waste management, water treatment, resilient infrastructures, a reduction of carbon emissions, sustainable agriculture and even health care and education.[26]

The good news is that change is on its way. Addis *et al.* (2013) witness a non-linear development of the emerging field of impact investing and characterize it as

26 It would be a mistake, however, to think that more established categories of impact investors would not face any issues in deploying capital. As recent research by Barclays Wealth and Investment Management (2015) demonstrates that a major hurdle for private wealthy investors is the lack of a total portfolio perspective and the perceived complexity of impact investing. Making as much money as possible on their regular investments and then giving part of the proceeds to charity are seen as the simpler option to contributing to the social good.

"pockets of innovation and waves"—and therefore of increasing market opportunities. These pockets enable evolution and integration of the existing systems and activity. The first signs of the new wave can be found in the activities of some of the largest pension funds and insurance companies, such as ABP, PFZW, TIAA-CREF, Ontario Teachers, ATP, BTPS, Shell Pension Fund, Unilever Pension Fund and some of the Swedish AP-funds. In 2014, some of these investors signed the Montreal Carbon Pledge (2014) and thereby committed themselves "to measure and publicly disclose the carbon footprint of their investment portfolios on an annual basis".[27] The policy is reflected in their investment portfolios, showing an exponential growth of green investments in renewable energy and green bonds. Thereby, the investors reduce their investment portfolio's carbon footprint. But actually they do more.

Based on an integration of Environmental, Social and Governance (ESG) information in their decision-making processes, institutional investors increasingly consider impact investment opportunities. At present the options for investment are scarce (Harji & Jackson, 2012; World Economic Forum, 2013a; World Economic Forum, 2013b). Therefore, institutional investors adopt a more idiosyncratic approach.[28] Dutch pension fund manager APG,[29] for example, doubled its exposure to "high sustainability investments" (HSIs) in 2014 from €15 billion to nearly €31 billion (or 7.5% of its total investments). HSIs are investments that, inter alia, contribute to solutions for climate change, water scarcity, pollution, bio-diversity or microfinance. The growth of the investment portfolio can be attributed to the increase in "green star" real estate investments 5–15 billion and, to a significantly lesser extent, in green bonds. PGGM,[30] an asset manager for the health care sector, invests in "solutions" in areas such as climate change, water scarcity, food production and health care. PGGM allocates €4.7 billion—or 2.5% of total assets—to these solutions. Concrete investments are made in, for example, a Chinese water purification plant leading to saving 210 million tonnes of clean water per year. Also, the fund manager invested in a shopping centre in Singapore leading to 30% water savings through the use of rainwater and water-efficient taps, and in 253,493 hectares of sustainably managed forests. In addition, PGGM requires asset managers to report on the social and environmental outputs and outcomes. It has developed a system for reporting on impact in a standardized way to its clients. Other pension funds take similar routes. A Deloitte survey of US-based pension funds on impact

27 http://montrealpledge.org

28 With a few exceptions pension funds and insurance companies will not invest in the multitude of fund options offered on the GIIN ImpactBase website. Most investment opportunities are either too small, with managers that are too inexperienced, focusing on non-OECD countries, or with a not good enough risk–return profile.

29 APG manages €412 billion (June 2015) on behalf of the largest Dutch pension fund, ABP, the pension fund for the building and construction industry, and a few smaller pension funds.

30 PGGM is the fund manager for the pension fund for the Dutch healthcare and wellbeing sector, the pension fund for Dutch general practitioners and a few smaller pension funds. It managed €182 billion at the end of 2014.

investing found that in 2013 6% of the respondents were making impact investments.[31] In the future, the report continues, "pension funds will more intentionally invest in organizations or funds that seek to achieve social or environmental objectives in addition to financial returns" (World Economic Forum, 2013a, p. 22).

Impact investments across asset classes

DOEN Foundation's Ecovative Design investment was made in a start-up company. The idea of investing in (social) enterprises is commonly shared by many impact investors. The Social Impact Investment Task force (2014, p. 16) even speaks of "the entrepreneurial revolution". "Now", the task force continues, "the emphasis is shifting to combining the forces of entrepreneurship, innovation and capital in order to improve peoples' lives". Although a focus on promoting social entrepreneurship is an essential part of the investment universe, impact investing offers a broader set of investment opportunities. In the words of Dichter (2014): "Under the broad umbrella of impact investments lie myriad sectors, asset types, and investment products, most of which still need to be developed and understood."

Many of these investments are related to the pressing social and environmental issues—from environmental pollution and climate change to access to health care, education and finance. Often instruments such as PE, private debt or VC are used—sometimes in combination with adequate risk mitigation measures. However, the term "impact investing" cannot or should not be limited to these specific investments. Allocating capital to green real estate or infrastructure that demonstrably adds social, socioeconomic or environmental value by creating and maintaining (affordable) housing, sustainable agriculture, roads, private hospitals, ditto schools, (waste to) energy plants, water treatment facilities and so forth are also part of the impact investment spectrum.[32] In effect, according to the World Economic Forum (2013b, p. 6) impact investing is an investment approach across asset classes, or a lens through which investment decisions are made, and not a standalone asset class (see also Social Impact Investing Taskforce G8, 2014). The impact investment universe consists of a range of different investment opportunities in different asset classes, ranging from cash[33] and fixed income to private equity, real estate and alternative assets, including hedge funds and infrastructure (cf. World Economic Forum, 2013, p. 19). Impact investing can, therefore, be considered a

31 It is difficult to provide a clear figure to determine the precise magnitude of this investment category because the Deloitte survey does not disclose how pension funds define impact investments. Looking at what happens in the global pension investment markets the figure of 6% seems to be on the (very) high end.

32 A recent development is the emergence of impact "bonds". These are actually not real bonds but "pay for performance" contracts and apply to challenges in areas such as youth employment, integration in the labour process of released prisoners (SIBs), healthcare (HIBs) and international development (DIBs). With less than US$200 million invested, this category is relatively very small and rather insignificant in relation to the global challenges we are facing.

33 See, for example, https://www.triodos.com/en/about-triodos-bank/what-we-do

form of regular investing in different asset classes, but with two clear distinctions. First, it intentionally attempts to create or maintain social, environmental and socioeconomic value. In this respect the impact investing philosophy is similar to

Box 1.2 **Distribution of impact assets across asset classes according to the GIIN survey 2016**

Of the US$77 billion in impact investments that was reported in the 2016 GIIN survey, 24% was allocated to social housing, 14% to microfinance and 10% to SME and corporate finance. Energy investments comprised 14% of the total amount of investments or some US$10 billion, while health-care investments attracted some US$4.5 billion in private capital investments. With only 2% of investments in infrastructure the impact investing market is clearly not ready for meeting the needs of the future, which, according to UNCTAD, requires an annual capital investment of US$1.6–2.8 trillion.

The results are based on a survey comprising GIIN members and organizations known to the GIIN that are part of its investor database. In 2016 156 respondents participated. The GIIN acknowledges that due to the self-reporting character of the survey results are indicative and do not provide a fully valid and reliable representation of size and allocation of investments towards asset classes.

As we will see later, more capital is invested in infrastructure than is reported by the respondents of the GIIN survey.

that of Porter & Kramer's (2011) concept of "shared value creation". And second, impact investing differs from mainstream investing in its commitment to manage and measure its extra-financial outputs and outcomes (see Box 1.2).

Returns

Right from the start in 2007 impact investors discussed the importance of financial and social returns. However, investors differed in the relative value they attached to both elements that can be found on the risk and return spectrum. This led to a distinction between "finance-first" and "impact-first" investors (Freireich & Fulton, 2009). It suggests that one group of investors has an overriding interest in financial returns, while the other groups mainly—if not exclusively—focuses on impact. Although not intended, the implicated either/or decision suggests a false dichotomy. The distinction is not particularly useful since it at least suggests that some philanthropic investors may not be interested in financial returns, while institutional investors may not be interested in social or environmental returns (Hummels, 2013). Particularly the latter is not true. Financial and social returns are

both important for *all investors*. It is simply a matter of prioritization and “where they want to be on the risk–return continuum” (Hummels, 2013). As Lewin (2013, p. 29) observes:

> Some investors may well be willing, or indeed require, some trade-off between return and impact. Others will seek out opportunities where return fully compensates for risk. Both play important roles. While the former can provide higher-risk capital to fund early stage social ventures, small scale entrepreneurs, etc., the latter can provide capital at much greater scale to fund sustainable growth.

At present little is known about the risks and returns of impact investments. The Wharton School of the University of Pennsylvania, in collaboration with the Emerging Market Private Equity Association (EMPEA), analysed more than 300 investment funds.[34] The objective of the study was to test “the widespread assumption that in making investments intended to achieve social objectives, investors are accepting more modest financial returns than they would if they were to choose investments solely on the basis of their return potential” (Gray *et al.,* 2015). The first results of the study show that the returns of private equity impact investments are in line with those of regular private equity (PE) investments. Another example comes from the GIIN, in collaboration with Cambridge Associates. A study on the financial returns of 51 PE impact funds shows that the impact funds are trailing the non-impact funds by 1.2% over the research period (1998–2010). Some segments of the impact investing market, however, outperformed their peer universe. Impact investment funds attracting less than US$100 million returned a net internal rate of return (IRR) of 9.5% to investors. Africa-focused funds performed even better than that (9.7%). Other segments of the market did less well. Impact investment funds of more than US$100 million returned 6.2% to their investors—an underperformance of more than 2% compared to the comparative universe (8.3%). Some impact investors such as foundations, family offices and wealthy individuals may be satisfied with these results. Others such as institutional investors might find them unsatisfactory.

Returns and risks

The Wharton study adds an important aspect to the performance discussion. It not only focuses on financial returns, but also on the risks involved. If impact investing is to become relevant for investors other than philanthropic foundations and wealthy individuals, it has to address both sides of the risk–return spectrum. Impact investments are often perceived as rather risky—even though that perception may not necessarily be supported by evidence. Institutional investors and DFIs require a deeper understanding of the risks of every impact investment. They rely on “a significant body of standardised policies and approaches to risk and return based on

34 This research was made possible by a financial contribution from Anthos Asset Management.

investment types that are better understood" (Addis *et al.,* 2013, p. 22). At the same time impact investments provide an opportunity, for example, because of their low correlation with more mainstream asset classes. As Christian Super CIO, Tim Macready, observes (Addis *et al.,* 2013, p. 9): "Impact investments offer returns that are expected to be largely uncoordinated with other investment markets."

The added value of diversification is more than simply an expectation. During the recent financial crisis investments in microfinance institutions have demonstrated to have a low correlation with the then declining financial markets in the developed world. Apart from the added value of risk diversification, impact investing therefore provides additional advantages to mitigate risks. In the first place, as TIAA-CREF's Amy O'Brien remarks, it is something participants and beneficiaries ask for. It "fulfils our participants' demand for both financial and social outcomes", she explains (World Economic Forum, 2013a, p. 5). Elsewhere O'Brien adds: "Another reason is that our proactive efforts have a positive effect on our relationships with state-level insurance regulators, some of whom prioritize meaningful, voluntary community investing" (World Economic Forum, 2013b, p. 23). A third reason is that impact investments can provide exposure to new markets and emerging sectors.

Into the investor's mind

The differences in risk–return expectations between investors require potential investees to have a proper understanding of the prevailing policies and practices of each investor. This is particularly relevant when dealing with institutional investors (cf. Hummels, 2013). At present developed world investors prefer to invest in those same OECD countries. This may change over time if too much money chases a limited amount of investment opportunities, thereby driving up prices—something that is about to happen in the market for infrastructure investments. At present, however, infrastructure in developing markets is often considered (too) exotic.[35] At the same time it is good to know that DFIs or public investors such as the Dutch,[36] the British or the Swedish government are specifically targeting non-OECD countries.

Managing and measuring outputs and outcomes

Impact investing distinguishes itself from socially responsible investing, program-related investing, mission-related investing (MRI) and traditional development finance by its focus on measuring outputs, outcomes and, potentially, impact. The literature points to four reasons for conducting impact assessments (Scriven

35 Conversation I had with mainstream investors who point out that, with a few exceptions, institutional investors will not consider investments in real assets in Africa, large parts of Latin America and the Middle East, or South and South-East Asia. Potentially acceptable are investments in Brazil, India, China, South Africa and maybe some of the emerging markets with stable governments and acceptable governance systems.

36 See, for example, the Dutch Good Growth Fund, a €750 million large investment fund investing mainly in non-OECD countries.

1967, 1991; Briedenhann & Butts, 2005; White, 2010; Patton, 2012; Contandriopoulos & Brousselle, 2012). An impact assessment gathers and assesses financial and extra-financial information that:

- Enables investors to **improve the investment-making** processes
- Allows investors to be **accountable** towards the beneficiaries
- **Empowers investees** to be actively involved in the evaluation of their own future
- Reflects the **community value** of the investments
- Sheds light on the **development** of that community

In the GIIN's definition of impact investing measurement is a crucial element. Initiatives to create, manage and *measure* social, economic and environmental impact are an integral part of every impact investment. Sirull & Thornley (2013) add two requirements to this condition. Any fund or enterprise that seeks recognition as an impact investment should provide an **impact plan** to investors and an annual **impact statement** that discloses the fund or enterprise's non-financial performance. It is important to demonstrate who the beneficiaries are of the intervention and what change it has actually brought. That is, however, easier said than done since the meaning of "impact" poses some challenges to the investor (see Box 1.3).

As both Webster's and Oxford dictionaries indicate, impact refers to "coming into contact with another object". So the word is often used to refer to situations in which, for example, cars are colliding, or missiles are "impacting" civil communities in military combat. More often, however, the term is used in a more generic sense to refer to the effect an intervention can have (*ex ante*) or has had (*ex post*). In this context, impact deals with the influence or effect of an intervention on a recipient. That is, the core of measuring impact is the ability to identify the **causal relationship** between the investment and the outcomes and to **attribute** the effects—both positive and negative to the investment (Patton, 2002, 2012; White, 2010; Gertler *et al.*, 2011; Bamberger *et al.*, 2012).

Establishing a causal relation is quite difficult, and attempts to attribute outcomes adequately to an investment pose significant difficulties. Many investors are happy to leave the difficulties aside and rather prefer to make assumptions about the impact that was created. As Bamberger & White (2007, p. 64) observe: "Many agencies define impact as simply comparing baseline measures with post project measures for the target population with no kind of comparison group and it is implicitly assumed that all of the changes can be attributed to the project intervention."

Clearly, in the academic discourse, this assumption is seen as erroneous. Looking for an alternative explanation provides a deeper insight into the social or environmental intervention and often sheds a different light on the causes of the occurring changes. Also in the field of policymakers and governments the focus is on

clarifying the relationship between the intervention and the outcomes that result from the intervention.

Depending on the objectives, mission and philosophy of the investors, however, establishing such a causal relationship may not always be necessary. The investors' need for information may differ and consequently their approach to measurement. Governments, for example, want or need to demonstrate the positive (and negative) effects of their investments as they work with public money. They operate within the context of *accountability*. This calls for summative or judgemental evaluations. A summative evaluation assesses the effectiveness of an investment. Its core question is: have the investment objectives been realized and was the investment instrumental in achieving those objectives? These evaluations often take place *on completion of the investment period*, so post hoc, and are used to decide whether or not the intervention will be continued or terminated.

Private investors, on the other hand, and particularly institutional investors, are usually more interested in measurement of (potential) outputs and outcomes to increase the chances of positive financial and social or environmental returns *during the investment period*. They tend to be forward-looking and their focus is likely to be on *monitoring and management of the intervention*. This calls for **formative evaluations**.[37] Formative evaluations focus on analysing the investment and gathering information that allows the investor—and the investment manager—to steer the investment in the desired financial, social and/or environmental direction. Measurement is relevant because it is instrumental in improving the management of the investment. The need for financial and non-financial information exceeds the purpose of post hoc justification of the investor's decision-making process, decisions and the effects of these decisions.

A colourful picture

DOEN Foundation gave Ecovative Design a head start, which larger investors or banks could not have achieved at the time. With the growth of the company and the move towards more mainstream capital, DOEN Foundation will water down its investment. This is a natural process. Banks or other providers of debt capital have to step in, while on the equity side more mainstream PE capital will be needed to support the growth. Section 3 painted a picture of a highly diversified and colourful impact investment landscape. Variation among and between groups of investors cannot only be determined post hoc, it is also an important precondition for the field to develop and grow. While (venture) philanthropy and mission-related investors are important in the early stages of impact initiatives, pension funds, insurance companies and asset managers come in further down the road. Governments have an important enabling role, just as large foundations that focus on building an impactful industry. The Bill & Melinda Gates Foundation,

37 The distinction between formative and summative evaluations was coined by Michael Scriven in 1967 and has ever since been an important evaluation typology.

the Rockefeller Foundation, the Ford Foundation, the MacArthur Foundation and Anthos AM provide great examples in this respect—not only by investing, but also by creating catalytic first loss capital guarantees or providing liquidity to illiquid funds. By de-risking financial transactions and enlarging the pool of capital that becomes available for social or environmental purposes, they contribute to creating a **financial value chain** and facilitate mainstream investors to come in. As Julia Stasch, president of the Macarthur Foundation explains about the new direction of the foundation: “We expect this new endeavor to use our capital and increased risk-taking, including market-making syndication, to give investors greater transaction ease, liquidity, confidence, and choice” (Daniels, 2015).

It appears that different investors have different roles in different stages of the development of an investment. DOEN’s insight that Ecovative Design’s biodegradable mycelium is scalable and replicable opens up a new world for the company, investors and the natural environment. It is due to pioneers recognizing the potential of revolutionary solutions that social and environmental change can be achieved. At the same time, it is the next investor in line taking over the baton that turns the initial investor into a builder of impact solutions. Without succession the pioneer remains a dreamer and the investment a mere opportunity waiting for its social or environmental potential to be realized.

Conclusions

When the participants of the Bellagio summit coined the term “impact investing” they could not have foreseen the impressive growth of the field in the years to come—nor could they reasonably have estimated the potential for growth. The first J.P. Morgan/GIIN study that was published in 2010 estimated the market would offer a potential for invested capital in the next decade somewhere between US$400 billion and US$1 trillion. This estimate is likely to be on the low side and to some extent falsifies the Monitor Institute’s (Freireich & Fulton, 2009) fear that impact investing may remain “a small, disorganized, underleveraged niche for years or even decades to come”. With the growing interest of DFIs, IFIs and institutional investors, and the development of more liquid instruments such as green bonds, impact investing will not be a “quantité négligeable”—although the field will have quite a pluralistic appearance. The field is likely to move from more “traditional” impact investments that particularly focus on enterprises with a positive impact on communities or our natural environment, to more mainstream investments that allow institutional investors to come in and contribute to some of the world’s most pressing problems regarding climate change and access to energy, water, food, housing, health care and education.

In the intermediary or developmental stage in which we find ourselves today this development requires collaboration between partners that have not so much

worked together in the past. Public agencies need to learn to work with private investors and businesses, while traditional grant makers should learn to team up with private investors. In the words of Chung & Emerson (n.d.):

> the entrenched historical and cultural differences between grant-making and impact investment institutions […] will need to be bridged. Some of these differences include differing views on the best use of capital (to address the highest need or to finance scalable solutions that only address part of the need), different processes and metrics for evaluating opportunities, different relationships with borrowers and grantees, and hesitation by both camps to cooperate.

It is only by new forms of collaboration between investors, and between investors and other stakeholders, that we will be able to realize financial, social and environmental objectives in parallel. Investors, governments, businesses and the civil society have to cooperate in ways that have not really been seen or tested before. Governments have to go beyond their role as legislator and develop—potentially in collaboration with or in addition to foundations—a context that creates leverage to bring in private investments. Among others, the Dutch, Swedish and UK government are testing new models that are essentially collaborative, and so are the MacArthur Foundation, the Ford Foundation and the Rockefeller Foundation. Through increased collaboration different stakeholders, often acting out of a sense of enlightened self-interest,[38] contribute to a virtuous circle with a positive impact on communities, the environment, investors and their beneficiaries. Money is thereby often not the issue. Organizing the change and working together will be the biggest challenge that the SDGs pose to our global society. Good intentions are not enough. It is what we do that ultimately decides how history will assess our efforts.

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38 The definition of impact investing, which focuses on the intention to do good while making a financial return, implicitly presupposes the idea of an enlightened self-interest. It goes beyond the interest to maximize financial returns in the short-term and requires a periodic calculation of the positive and negative outputs and outcomes of an investment. Unfortunately, as for example the 2010 Andhra Pradesh microfinance crisis demonstrated, theory and practice are not always aligned. Short-term interest do sometimes prevail.

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