Solutions for Impact Investors: From Strategy to Implementation Godeke Pomares

Solutions for Impact Investors:

From Strategy to Implementation

ROC Philanthropy Advisors

Solutions for Impact Investors:

From Strategy to Implementation

Steven Godeke
Raúl Pomares

with

Albert V. Bruno
Pat Guerra
Charly Kleissner
Hersh Shefrin

table of contents

5 **Foreword & Acknowledgements**

9 **Chapter 1: Introduction**
From Strategy to Implementation
Impact Investor Categories: Commercial
and Philanthropic
The Target Audiences
Publication Goals
Beyond the Tyranny of OR
Uncertainty and Risk
Behavioral Finance and Impact Investing
Challenges Ahead
The Impact Investing Cycle
Harnessing the Genius of AND

23 **Chapter 2: Articulating Mission and Values**
The Road Map
Applying the Road Map/Articulating the Mission
RSF Social Finance
KL Felicitas Foundation
Calvert Social Investment Foundation
Impact First, Financial First and Blended Transactions

31 **Chapter 3: Creating Impact Themes**
Impact Investment Theme Selection
Selecting the Right Partners and Advisors
Impact Investor Resources

37 **Chapter 4: Defining Impact**
Impact Investing Tools & Tactics
Active Ownership Strategies
Screening
Impact First Investments
Financial First Investments
Guarantees
Articulating An Impact Investment Thesis

Meyer Memorial Trust's Geographic Impact Thesis
Evolution To More Direct Impact
Beyond Rational Man: Incorporating Behavioral Finance in Impact Investing
Market Failures and Impact Investing

55 **Chapter 5: Developing an Impact Investing Policy**
Asset Allocation Basics
F.B. Heron Foundation's Mission-Related Investment Approach
Asset Allocation and the Impact Investor
Relationship Between Risk & Return
Measuring Financial Risk
Correlation: Diversifying Asset Classes to Reduce Risk
Microfinance and Correlation
Asset Class Framework
Mapping Impact Themes to Asset Classes
Applications Across Impact Themes
Developing the Investment Policyemes

95 **Chapter 7: Analyzing Deals**
Due Diligence of Impact Investments
Investment Processes
Pico Bonito Investment Process
Triodos Sustainable Trade Fund Case Study
Dial 1298 For Ambulance Case Study

115 **Chapter 8: Evaluating Impact**
Defining and Measuring Impact
Core Beliefs for Impact Assessment
Beartooth Capital
One Family's Approach to Microfinance and Impact
Creating Structural Change for Measuring Impact

123 **Conclusion: Coming Full Circle Using the Impact Investing Cycle**

128 **Appendices:**
Impact Investment Profile Summary
Selected Bibliography
About the Authors
Important Disclosures

foreword

Since we published *Philanthropy's New Passing Gear: Mission-Related Investing* in early 2008, the investment and philanthropic landscape has changed dramatically. Despite the global economic volatility we have seen in the past year, and perhaps in part a result of it, interest in impact investing — creating social and environmental impacts in addition to investment returns — has grown significantly. Investors are creatively challenging the status quo in order to address major problems such as poverty, climate change and the inequality between rich and poor.

While organizations serving the needs of investors and philanthropists interested in this approach have begun to multiply, and new tools are being developed to provide insights into how people and markets interact, barriers still exist. There is a clear need for established best practices and for practical guidance in developing an asset allocation framework; sourcing investment opportunities; performing due diligence on managers and opportunities; understanding the behavioral and external factors that motivate investment decisions; analyzing risk and return from a financial, social and environmental perspective; as well as measuring and benchmarking the performance and impact of these types of investments.

The pathways to scaling social and environmental innovation are also changing. Collaborations among the public, private and social sectors have proliferated as governments have responded to the current financial crisis and sought to find innovative means to address these challenges. While philanthropy has always relied on other sectors to co-create and sustain social change, the fact remains that governments and traditional philanthropy do not have sufficient funds to address the world's most serious problems. Commercial capital and the tremendous power of market forces will have to be part of the solution.

Solutions for Impact Investors: From Strategy to Implementation aims to increase the rigor with which impact investors frame their investment decisions and demonstrate the integration of impact investing across asset classes. In conjunction with the team of academics and practitioners who have produced this monograph, Rockefeller Philanthropy

acknowledgements

The authors wish to thank everyone who helped inform and inspire this publication. We especially extend our gratitude to our advisory council — a passionate group of impact investors, academics and practitioners. This guide would not have been possible without their invaluable input and support.

- Doug Bauer, Executive Director, The Clark Foundation;
- Antony Bugg-Levine, Managing Director, the Rockefeller Foundation;
- Mark Campanale, Director, Halloran Philanthropies;
- Sam Collin, Charity Adviser, EIRIS Foundation;
- Lisa Hagerman, Director, More for Mission Campaign Resource Center;
- Al Hammond, Senior Entrepreneur, Ashoka;
- Pamela Hartigan, Director, Skoll Centre for Social Entrepreneurship at Oxford Said Business School;
- Harry Hummels, Professor of Economics and Business Administration at Universiteit Maastricht;
- Steven Lydenberg, Chief Investment Officer, Domini Social Investments and Vice President of the Domini Funds;
- Preston D. Pinkett III, Vice President, Social Investment Program, Prudential Financial;
- Meir Statman, Glenn Klimek Professor of Financm…Schm7—5-9…ihil

We also wish to thank the following colleagues who helped develop case studies and review the text: Shari Berenbach, Melissa Berman, Candi Deschamps, Julian Himes, Koert Jansen, Robert Katz, Tracy Palandjian, Carl Palmer, Luther Ragin, Jr., Ravi Shankar, Gary Schick, Don Shaffer, Gary Sprague, Doug Stamm, Bill Tarr, Joan Trant, Brian Trelstad and Rosa Wang.

Hasani Sinclair served as lead researcher for the impact investment profiles featured in this guide and on RPA's Web site; and Rob Steiner contributed to the final format and content of these profiles.

The authors received strong editorial support from Lisa Kleissner and Lauren Russell Geskos. The book was beautifully designed and produced by Art270. Patricia Holland Design contributed to the design of many of the graphics.

We would like to extend special thanks to Charly and Lisa Kleissner from the KL Felicitas Foundation; Antony Bugg-Levine and Brinda Ganguly from the Rockefeller Foundation; Russ Hall and Alan Marty from Legacy Works; Jesse Fink from the Betsy and Jesse Fink Foundation; Stuart Davidson from the Woodcock Foundation; and Steve Toben from the Flora Family Foundation. Without their enthusiasm and support, this publication would not have been possible. We are grateful for their commitment to impact investing and to broadly disseminating its potential to as wide an audience as possible. This work also builds on the pioneering work of the F.B. Heron Foundation.

Finally, please let us know what you think. Please send

Chapter 1:

Introduction

From Strategy to Implementation: How can our investments make a difference? How can we maximize our impact?

As we look out at the challenges facing the world and the limits of the current resources addressing them, we see impact investing playing a central role in bringing forward real solutions. We believe impact investing can create social good at scale and begin to address some of the world's most pressing problems where commercial markets and donor-based programs have not. The sharp dichotomy between profit-maximizing financial investment and "give-it-away" charity is gradually losing its edge. Jed Emerson has used the term "Blended Value Investing" to describe this combination of investment and philanthropy. He concisely framed the concept in the following:

1

However, if we want to ensure that our good intentions create real impact, these aspirations must be supported by a well-considered investment strategy and a rigorous execution process. Impact investors are now able to execute strategies across a range of asset classes, risk-adjusted financial returns and impact themes — these investors face the challenge of selecting outstanding impact investments directly or indirectly through the appropriate funds which, in turn, evaluate and select the impact investments. Given the growing opportunities in today's marketplace, these strategies can and should be driven by an impact investor's dual goals of addressing specific social and/or environmental impacts while seeking an appropriate level of investment return. Our team of academics and impact investment practitioners set out to explore the structures and processes impact investors can use to tighten the link between investment decision-making and generation of impact. We have chosen the broader term "impact investing" in this monograph since its relevance extends to individual and institutional investors in addition to philanthropic investors such as foundations where mission-related investment would describe this activity.

As we seek to create impact and investment return simultaneously, the framing is critical. By clarifying our definitions of investment and impact, we can better understand some of the assumptions and views people bring to this field.

a meaningful change in economic, social, cultural, environmental and/or political conditions due to specific actions and behavioral changes by individuals, communities and/or society as a whole.[2]

the choice by an investor to risk his or her assets with the goal of a financial gain in the future.

Are these two objectives at cross-purposes? Must we sacrifice return in order to generate impact, or conversely, must we dilute impact to gain additional financial return? Is there a middle ground between creating dependencies through grantmaking and sacrificing long-term sustainability to achieve

These investors may be driven by fiduciary requirements as in the case of pension plans.

seek to optimize social or environmental returns with a financial floor. This group uses social/environmental good as a primary objective and may accept a range of returns, from principal to market-rate. This group is able to take a lower than market-rate of return in order to seed new investment funds that may be perceived as higher risk, or to reach tougher social/environmental goals that cannot be achieved in combination with market-rates of return.

Looking across the universe of impact investors, it is important to keep this distinction in mind in order to understand the investment opportunities specific impact investors will pursue. However, investors may also make both financial first and impact first investments. This clear separation between financial returns and impact may be less appropriate for investors who use a broader, more integrated approach — including both financial and non-financial factors — when evaluating their investment opportunities.

The Target Audiences

Solutions for Impact Investors: From Strategy to Implementation is written from the perspective of the impact investor supplying the capital rather than the enterprises using the capital. Our expected audience includes investors who may have already made impact investments, but have not yet connected these investments to their overall investment strategy, and traditional investors who have not made impact investments and struggle with how impact investing can be integrated into pre-existing asset allocation and portfolio management models. While we acknowledge the important role which grant-based philanthropy can play in furthering social and environmental goals, it is not the focus of this monograph. Interested readers include:

- Philanthropic investors seeking to enhance their knowledge of social, mission-related and program-related investments;
- Individual investors (e.g., high net-worth individuals);
- Institutional investors (e.g., pension fund managers); and
- Advisors (wealth management advisors, investment advisors and family trust advisors) seeking to provide their clients with impact investment opportunities.

Publication Goals

In writing this monograph, our main goal is to provide impact investors with tools to tighten the link between their investment decisions and impact creation. Our intent is threefold: to attract more capital to impact investing; to assist impact investors as they move from organizational change to executing and refining their impact investment decision-making process; and to narrow the gap within foundations between program professionals and investment professionals thereby contributing to a mutual understanding and implementation of a portfolio approach to impact investing.

Additionally, we intend to help break down the barriers making it difficult to identify opportunities in impact investing. To this end, we provide examples throughout the monograph and at www.rockpa.org/impactinvesting of impact investment opportunities in most major asset classes.

- Creating new impact-related processes AND operating within strict investment policy discipline;
- Optimizing for environmental & social impact AND applying the rigor of investment management tools;
- Investing in new markets & asset classes AND maintaining exposure to traditional investment strategies;
- Embracing new business models AND adhering to recognized financial theory;
- Evaluating impact performance AND subjecting investments to recognized financial benchmarks; and
- Expanding the scope and scale of philanthropic capital AND maintaining adherence to fiduciary responsibilities.

Throughout this monograph, we illustrate how the impact investor can embrace the Genius of AND to successfully develop and execute a rigorous approach, utilizing existing portfolio theory and investment discipline.

Uncertainty and Risk

The generation of investment returns and impact requires us to take actions we hope will deliver positive social and financial returns in the future. Whether making a loan or funding a program, this desired future outcome is subject to risk. We must understand that both investing and generating impact operates under uncertainty. Given this uncertainty, we need to stay alert to both the societal changes we seek and the changing investment environment and formulate clear investment policies to express our risk preferences and ensure well-informed and focused investment decisions.

Behavioral Finance and Impact Investing

In addition to embedding impact investing within the traditional investment framework of risk and return, we would like to explore how elements of behavioral finance can be applied to the discipline of impact investing. Traditional finance uses models in which people are self-interested and rational. While this framework is appealingly simple, evidence from psychology, economics and finance indicates that both assumptions are unrealistic. People can be altruistic and less than fully rational. With the study of rationality, the behavioral finance literature emphasizes that both investors and managers of firms deal with most of us ‘satisfice’ rather than optimize, meaning that we are content with decisions that achieve some goal with which we shall be satisfied, rather than delaying a decision until we find the absolute best alternative;

- Recognize that you, and others, will be relying on rules of thumb to make your decisions; and
- Recognize that the challenge is to find sensible rules of thumb. Indeed, one goal of this monograph is to provide sensible heuristics for impact investing.

Throughout the monograph we highlight behavioral finance issues, how they affect investment decisions, and how these issues can be addressed in the context of impact investing. Along with specific guidelines, we also provide general suggestions for mitigating bias. Finally, we help investors develop a menu of sensible behavioral finance questions to assist in the investment evaluation process.

Challenges Ahead

Translating impact investing from a concept into action raises several challenges we wish to address:

- How do impact investors formulate a strategy to support their mission and values and then find the appropriate investment opportunities to realize that strategy?
- How are impact investors’ intentions to create financial returns and a social or environmental impact captured in the evaluation and selection of impact investing opportunities?
- What is the appropriate operating framework for evaluating impact investing options?
- Given the broad universe of potential impact investments, how

can impact investors most efficiently and effectively make these investment decisions?

- How can investments be made at sufficient financial scale without diluting the impact?
- How can organizations develop an impact investing policy to address strategic and governance issues?
- What are the organizational changes needed to implement impact investing and how can impact investors select the right advisors and partners?
- What are the appropriate legal structures for impact investing vehicles?
- How can impact investors evaluate the trade-off between a focus on specific impact themes and the need to apply portfolio diversification and asset allocation tools most effectively?
- How can impact investors integrate aspects of behavioral finance?

To provide a framework in which impact investors can move toward action, we separate impact investing into two distinct activities:
(1) Establishing an Impact Investing Strategy; and
(2) Implementing and Maintaining an Impact Investing Strategy.

The Impact Investing Cycle

We first outline how an impact investor can develop a strategy and then translate that strategy into concrete implementation steps. In this split between strategy and execution, we see the Impact Investing Policy as the critical link. The Impact Investing Policy is the tangible result of establishing an Impact Investing Strategy. It explicitly articulates hypotheses, or theories of change, about how the investment will generate a social and/or environmental impact. To date, these assumptions have not typically been rigorously defined, and investors have relied on loose theories of change in order to support their investments. Most impact investors have expended considerable effort in developing and articulating their mission and are now projects inspired by the work of social philosopher Rudolf Steiner. Today, RSF's mission is to transform the way the world works with money by providing innovative investing, lending and giving services that address key issues in the areas of Food & Agriculture, Education & the Arts, and Ecological Stewardship.

- **The KL Felicitas Foundation** (www.klfelicitasfoundation.org), a California-based private family foundation, was established by the Kleissner family in 2000 with the following mission: to enable social entrepreneurs and enterprises worldwide to grow harnessing the Genius of AND to effect real change across impact themes ranging from community-based water projects in the developing world to improving education in the US. We hope to inspire you to roll up your sleeves and take on the hard but rewarding work of impact investing and make its promise a reality.

---

1 www.blendedvalue.org

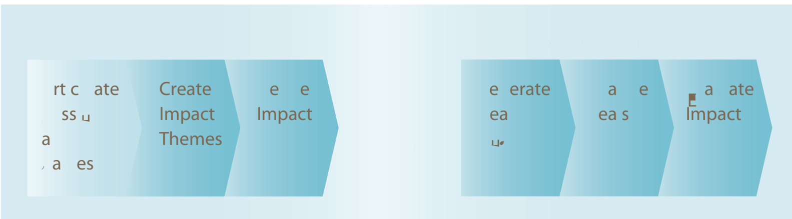
2 "McKinsey's Approach to Learning for Social Impact," Discussion Paper, Draft June 2009.

3 Freireich, Jessica and Katherine Fulton, "Investing for Social & Environmental Impact," Monitor Institute, 2009.

4 Collins, James C. and Jerry I. Porras, "Built to Last: Successful Habits of Visionary Companies," 1997.

Chapter 2:

Articulating Mission and Values



The Road Map

Your impact investing strategy should be firmly aligned with your personal or institution’s core values and mission. Reflecting Rockefeller Philanthropy Advisors’ own mission of helping donors create thoughtful, effective philanthropy throughout the world, the following questions were developed as a Philanthropic Road Map to assist donors in structuring their goals and missions. We have adapted this Philanthropic Road Map to become the Impact Investing Roadmap. This tool can help you clarify your motivations, select impact themes, determine your approach to these issues and structure your actions. Consider the following questions as a way to determine your current position and clarify assumptions before formalizing an impact investing strategy.

Some answers include: seeking an enhanced financial return while making positive social and/or environmental impacts; heritage; expression of values; leaving a legacy; affiliations; causes; involving younger generations; environmental awareness; social

Y

What is your tolerance for risk? How do you define success or progress toward your goal?

The complete Impact Investing Road Map should identify your motivations and issues, define your goals and approaches for key issues, and select the appropriate types of investments. It will become part of your Impact Investing Policy. Based on this Road Map, you will be in a position to see and assess results, and adjust as needed. Your mission and values can then be operationalized through the appropriate legal structures and investment vehicles.

Applying the Road Map/Articulating the Mission

We first present how RSF Social Finance, the KL Felicitas Foundation and The Calvert Social Investment Foundation developed their missions, created their impact investing philosophies and identified their impact investing themes. We also note how they approach financial first and impact first transactions and select their partners and advisors. We then highlight how they have translated their strategies into concrete impact themes in order to reflect their theories of change. And finally, we share how they are applying tools such as asset allocation and portfolio theory to deal generation, due diligence, portfolio monitoring and a customized evaluation process to fine tune their strategies over time.

RSF Social Finance

RSF Social Finance (RSF) was incorporated in 1936 and until 1983 engaged exclusively in fundraising and charitable giving to organizations inspired by the work of Austrian social philosopher Rudolf Steiner. In 1984, RSF began providing direct loans to organizations that likewise supported Steiner's insights on associative economics and social renewal. Then, in the late 1990s, RSF expanded its mission to serve a broader range of clients with compatible values and intentions, including those engaged in non-profit and for-profit social enterprise. Today, RSF offers investing, lending and philanthropic services. RSF strives to create innovative financial vehicles that not only generate deep social and environmental impact, but also foster community among participants. RSF currently has more than 1,000 clients and $130 million in consolidated assets, and has made over $190 million in loans and over $90 million in grants since 1984.

RSF frames all of its work in terms of an overarching purpose to transform the way the world works with money. This purpose is informed by the following set of core values:

Spirit: The primary role of money is to serve the highest intentions of the human spirit.

Trust: People are best served by financial transactions that are direct, transparent and personal, based on long-term relationships.

Interdependence: Economic success will be defined by social and ecological impact, not by financial results alone.

Community: Networks and associations will be increasingly important in the circulation of money.

Innovation: A deeply entrepreneurial culture is required to generate breakthrough ideas at the intersection of social change and finance.
Equality: All those seeking to align their values and their money will have access to opportunities for investing, lending and giving.

With regard to impact investing, RSF offers funds designed to serve a range of individual and institutional investors. The funds include a core lending program of short-term notes supporting non-profit and for-profit social enterprises; a mezzanine debt fund providing growth capital for for-profit social enterprises; and a program-related investment (PRI) fund designed for foundations wishing to invest in PRIs but lacking the in-house capacity to do so.

KL Felicitas Foundation

The KL Felicitas Foundation (KL Felicitas) founders, Charly and Lisa Kleissner, first became interested in sustainability, mission and social investments as a way to break down the "value/ethic firewall" between their personal and business lives. Impact investing is a logical extension of their core beliefs. It enables the foundation to use a wide range of investment vehicles to support social enterprises, including grants, social loans, loan guarantees and private equity. Impact investing also allows family foundations like KL Felicitas with assets of approximately $10 million to maximize their impact by augmenting annual grantmaking with the effects of an investment strategy aligned with their mission. The Kleissners apply the following approach/values to their personal lives and work including their role as trustees of the foundation:

- Commitment to high touch;
- Belief that a grass-roots approach is more successful and sustainable than a top-down approach;
- Belief that systemic societal problems can be addressed most effectively through cross-sector partnerships, market forces and/or hybrid solutions;
- Commitment to leverage as many aspects of the foundation's structure and activities as possible; and
- Commitment to considering the holistic impact of everything they do.

Calvert Social Investment Foundation

The Calvert Social Investment Foundation (Calvert Foundation) was launched in 1988 with the mission of maximizing the flow of capital to disadvantaged communities. Although it was launched with the support of Calvert Group, Ltd., and major national foundations, Calvert Foundation operates as an autonomous non-profit entity. Calvert Foundation's investment philosophy is to provide investors a modest financial return while generating a high social impact. The foundation is able to provide needed capital to underserved markets while seeking to control risk for investors. Calvert Foundation places loans primarily with affordable housing lenders and developers, small business lenders, microfinance institutions and other community development organizations that have a track record of success. Calvert Foundation operates three main programs:

Community Investment Notes:

foundation paying investors a below-market fixed interest rate. Investors accept this below-market interest rate in exchange for supporting the positive social impact generated by Notes proceeds. These proceeds are invested in a diversified pool of high credit-quality non-profit financial intermediaries, federally-insured community development banks and credit unions, affordable housing developers, marketable fixed income securities, microfinance institutions, fair trade cooperatives, and for-profit social enterprises. As of year-end 2008, Notes sales exceeded $158 million to more than 4,600 investors.

Community Investment Partners:

Community Investment Partners (CIP), Calvert Foundation's business services unit, offers consulting, analysis, asset management and capital markets solutions to institutional and individual investors who wish to create or enhance their community investment programs, and to organizations wanting to raise capital through non-traditional distribution networks. At year-end 2008, CIP was servicing 26 clients, representing an additional $66 million in community investment assets under management.

Calvert Giving Fund:

The Calvert Giving Fund, Calvert Foundation's socially responsible donor-advised fund, provides donors opportunities to: make tax-deductible donations to the Giving Fund; invest their donated assets in the Calvert Group socially-screened mutual fund Notes, or alternative socially responsible instruments; and recommend donations to non-profit organizations around the world. Calvert Giving Fund was launched in 2000, and at year-end 2008 had net assets of over $26 million from 413 donor-advisors.

Impact First, Financial First and Blended Transactions

As demonstrated by RSF, KL Felicitas and Calvert Foundation, impact investors can have distinct approaches to the question of financial return and impact. Calvert and RFS offer impact first only investments to their clients. KL Felicitas utilizes all three types of investments in their portfolio — impact first, financial first and blended transactions.

In some circumstances, investors with different return requirements will co-invest in the same enterprise or project. In these collaborative deals, it makes sense for the financial first and impact first investors to combine capital to fund the transaction. This type of structure is also widely used by the public sector to attract capital into particular target programs or industries (e.g., the US Federal Government's Low Income Housing Tax Credit or the International Finance Corporation's risk-sharing structures with private investors). In these structures, the impact first investors must be very clear as to how their subsidy of financial first investors is increasing the overall impact and capital of the project and not just de-risking the deal for the commercial investors.

KL Felicitas supports the view that many systemic approaches to social issues require a partial subsidy in the form of a grant or a PRI. In these deals, the partial subsidy often reduces the risk for the financial first investment in a partner organization. These types of hybrid investments should ideally achieve an impact that could not otherwise be accomplished.

0

- Community Development;
- Social Enterprises;
- Health & Wellness;
- Sustainable Development; and
- Education.

The impact themes RSF, KL Felicitas and Calvert Foundation have used to define their impact investment activities provide insight into how impact investors are translating impact goals into investment themes. Even among these impact investors, there is a clear diversity of impact themes. The integration of impact themes across investment asset classes is presented in Chapter 5.

RSF Social Finance:

RSF's impact themes are derived from its three impact focus areas: Food & Agriculture; Education & the Arts; and Ecological Stewardship. Food & Agriculture supports diversification, region-first approaches and sustainable practices. Education & the Arts invests in initiatives that address the intellectual, emotional, aesthetic and social needs of children and adults. Fine arts and performing arts include investments that foster spiritual awareness or increase access to learning and the arts for all communities; entrepreneurship, job training, consumer education and other awareness-building programs; and handicrafts produced and distributed according to fair trade principles. Ecological Stewardship promotes energy- and eco-efficiency; green building materials and green consumer products; ecological remediation and restoration, land conservation and land trusts; and environmental legal defense.

KL Felicitas Foundation:

KL Felicitas Foundation's mission is to enable social entrepreneurs and enterprises worldwide to grow sustainably, with an emphasis on rural communities and families. These social enterprises can be for-profit ventures, non-profit ventures, or hybrid ventures that combine the passion and aspiration of a social/environmental mission with the discipline, innovation and determination commonly associated with a for-profit business. These social enterprises should have one or more of the following characteristics: (1) they provide goods and services for the poor or disadvantaged, and/or (2) they employ people from the poor or disadvantaged, and/or (3) they are majority owned by the poor or disadvantaged communities. KL Felicitas

Selecting the Right Partners and Advisors

Building the right team to execute an impact investing strategy is critical to your success. While other sectors of investment management such as tax, legal and portfolio management have become increasingly specialized, you may find that impact investing falls between the insulated fields of philanthropy and investment. Several barriers exist for the efficient delivery of impact investment advisory services:

- Impact investing requires active ownership, and there are typically several layers of intermediaries between the asset owner (donor, trustee, individual, institution) and the ultimate deployment of the capital;
- Disconnect between long-term investment objective of impact investors and investment consultants who are evaluated on a short-term basis;
- Lack of consensus on how to define and measure social and environmental impact with most consultants either using a “you-know-it-when-you-see-it” approach, or deferring judgment on social and environmental issues to their clients;
- Advisors typically focus on select assets rather than offering services across all asset classes;
- Lack of existing investment infrastructure means significant cost associated with research and due diligence of impact investments, particularly for international strategies; and
- Lack of consensus and/or understanding between investor and advisors on impact thesis.

At present, the relationship between impact investors and their financial advisors follows two distinct models:

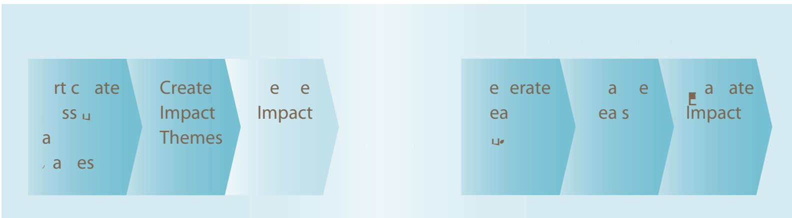
- The financial advisor may also be the impact investment advisor; or

- Impact analysis is provided separately by a specialist and must be coordinated with traditional financial advisors' workflows.

Despite these challenges, new service providers have emerged to provide solutions due to the pioneering efforts of impact investors throughout the field. These new service providers include institutional consulting firms, global asset management firms, private banks, specialized product providers, boutique advisory practices and thematic research providers along with peer networking and collaborative investor groups of impact investors. These impact advisory service providers are helping to break down the barriers and build the field of impact investing.

Chapter :

Defining Impact



Impact investors generally make assumptions about how their investments can translate into desired social or environmental impacts. Some of these assumptions are explicit in terms of outputs while others are implicit. These impact investment theses are also known as theories of change and describe the step-by-step process through which a particular investment activity will translate into a desired outcome. In *Philanthropy's New Passing Gear: Mission-Related Investing*, we defined five distinct tools impact investors can use. Each has its own impact investment thesis. The first tools of active ownership strategies and screening are values-based tactics. The other three — financial first investments, impact first investments and guarantees — have specific social and environmental impacts and represent the majority of the impact investing we will outline in this monograph. For each of the tools, we have included the related impact investment thesis or theory of change.

Impact Investing Tools & Tactics

Active Ownership Strategies

As a long-term owner and fiduciary of holdings in publicly-traded securities, you have the ability to influence corporate behavior and further your desired impact through proxy voting, shareholder resolutions and informal shareholder engagement with the corporate management of the companies you hold in your portfolio. Many companies have changed their policies and practices on a host of issues important to impact investors, not only because of market forces, but also because their shareholders demanded change.

Impact Investment Thesis: Constructively engaging with the management of publicly-traded companies through proxy voting, shareholder resolutions and engagement will cause companies to stop undesired activities or begin desired activities of importance to a specific impact investor and to the company's array of stakeholders.

Screening

Screening is the practice of buying and selling publicly-traded securities based on the evaluation of impact criteria that reflect your personal or institution's values. Your investment decision may be to avoid certain companies (negative screening) or to support particular companies (positive or best-in-class screening). The ultimate goal of screening is for your portfolio to reflect your values and mission, mitigate risks and use your investment capital to encourage or discourage specific corporate behaviors.[5]

Impact Investment Thesis: The buying and/or selling of a publicly-traded security will cause companies to stop undesired activities or start desired activities.

Active Ownership Strategies and Screening can also

Guarantees

Guarantees are another important tool impact investors use to mitigate the credit risk created by an organization when it receives a loan from a bank or other lending institution. You can use your assets as collateral to provide security (guarantee) to an organization based on this collateral. Unlike other impact investments, a guarantee may not require upfront deployment of

Finance has developed distinct impact criteria for evaluating potential loans through its Core Lending program:

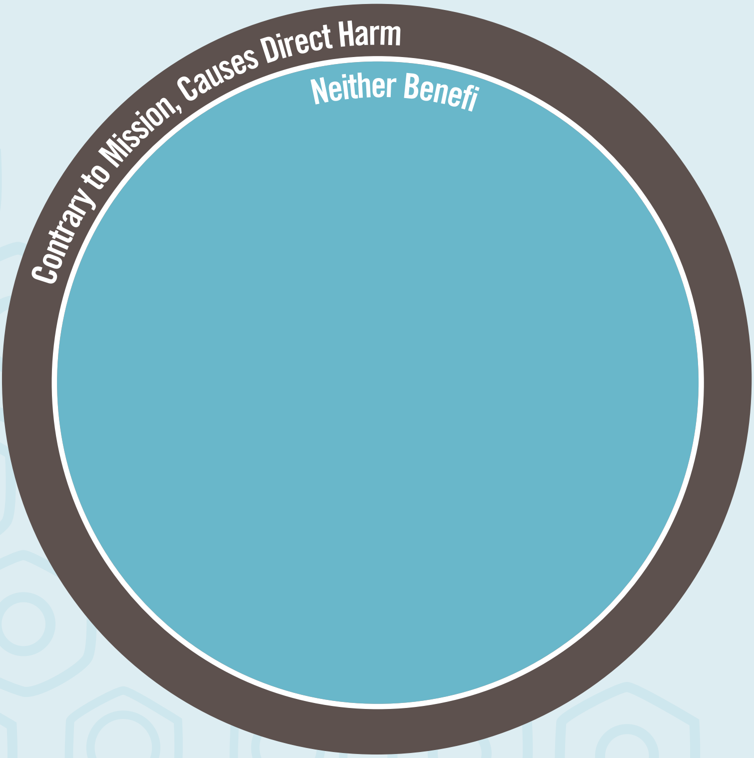
Core Lending Impact Criteria

- Product — generates major shift in consumer preferences.
- Manufacturing processes — utilizes sustainable energy use, waste management, etc.
- Supply chain — seeks highest values alignment possible.
- Employee practices — strives for high positive impact; includes profit/ownership sharing.
- Community — maintains strong presence beyond token contributions.
- Governance Structure — allows entrepreneurs' values to stay intact.
- The entrepreneur is committed to changing the rules and practices of an entire industry.

For Calvert Foundation's Community Investment Note, potential borrowers must have an explicit focus on serving low-income communities and individuals, or on providing financial services to individuals without access to traditional sources of capital. Borrowers must be engaged in community development initiatives that help expand opportunities, promote job growth, develop small business and promote homeownership in underserved areas. The foundation lends to organizations that work in both urban and rural settings, in the US and abroad.

The Calvert Foundation's Global Impact Ventures (GIV) funds allow donor advisors to invest in funds that have private debt and/or equity stakes in social enterprises, innovative non-profits and microfinance institutions. Many of them provide unique "gap-filling" financing — channeling capital to markets that cannot get financing from traditional commercial sources.

funds based on RSF's cost of capital, as is typical for many non-profit intermediaries. Beginning in 2004, RSF designed a traditional socially-responsible investment (SRI) program (i.e., screening and active ownership strategies) by contracting with several SRI asset managers within three portfolios — Equity, Fixed Income and Cash. Investments were primarily in public equity, public debt and cash, making it difficult to determine the degree to which investments were aligned with RSF's mission and theory of change. In 2005, RSF moved to a more directly managed SRI program with one institution providing expertise



Source: Meyer Memorial Trust

in the field of screening, advocacy and solutions-based impact investing. Nevertheless, as investments were still primarily in public equity, public debt and cash, it remained difficult to determine the impact being generated.

Following a strategic review in 2007, RSF designed and implemented a more direct and transparent donor-advised fund investment program in order to achieve the deepest possible social impact through these investments. As part of this new program, RSF expanded its holdings in private equity and private debt vehicles, and modified its due diligence process to include more extensive analysis of potential investees' social impact. Donor-advised fund accounts are now invested in three portfolios called Impact, Liquidity and Transformation, all of which aim to reduce unnecessary levels of intermediation while continuing to meet rigorous diversification, risk and return criteria. Within the Liquidity Portfolio, for example, RSF has begun the process of transferring all money market and commercial paper investments into deposits at the highest-performing community development and environmental banks in the country. Within the Impact Portfolio, RSF invested in Beartooth Capital, a private real estate fund that generates strong financial returns through the restoration and protection of ecologically important ranch land. (See Case Study in Chapter 8.) This investment contributed both to RSF's goal of making more direct investments as well as diversifying the portfolio through the addition of real assets. Going even further toward direct investing, the Transformation portfolio is designed to make direct venture and debt investments in enterprises that seek to solve the most pressing social and environmental issues of core importance to RSF and its clients. RSF believes that by pursuing more direct investment opportunities, it will be better able to ensure mission alignment and report on the concrete social and environmental impacts of its investments.

KL Felicitas Foundation

KL Felicitas initially used negative screening as its impact investing strategy, but soon realized that the impact was indirect, unleveraged and unaligned as well as nearly impossible to measure. At the same time, they made the strategic decision to hire a team of advisors rather than rely on any one consultant or firm to provide full services. This approach brought together the best possible team from multiple disciplines (e.g., family coach, family office manager, tax advisor, philanthropic advisor and investment advisor). In addition to providing the desired 'checks and balances,' this approach fosters high engagement by all team members.

The Kleissners began to explore philanthropy more deeply and were introduced to Jed Emerson's thoughts on blended value investments. Participation in The Philanthropy Workshop West (www.tpwwest.org) and the Global Philanthropy Forum (www.philanthropyforum.org) further exposed them to international investment and grant opportunities. A key turning point in the process occurred when the foundation merged its impact investing policy with its asset allocation strategy and formalized the deal flow process. KL Felicitas organizes its impact investing activities into four categories: Sustainability Investments, Mission-Related Investments, Program-Related Investments and Social Component Investments. It is important to point out that the Kleissners are not only engaged in impact investing in their family foundation, but are actively doing impact investing with the assets of their Family Limited Partnerships and Charitable Remainder Trusts as well.

KL Felicitas believes that helping social entrepreneurs and social enterprises reach scale in a more sustainable and impactful way can make a meaningful contribution to the alleviation of poverty, as these social enterprises either provide affordable goods and services or meaningful employment for the poor and disadvantaged.

In addition to Program-Related Investments and Mission-Related Investments, KL Felicitas also uses 'Sustainability Investments' and 'Social Component Investments' as part of its overall impact investment strategy. The foundation has set an aggressive goal to move to 100% impact investments. Since it will take time to find appropriate Mission- and Program-Related Investments for all its assets, KL Felicitas decided to invest and track 'Sustainability Investments' and 'Social Component Investments' (aligned with their values, but not with their mission or programs) while moving into more Mission- and Program-Related Investments.

KL Felicitas defines Social Component Investments as investments that allocate part of their profits either directly or indirectly to social beneficiaries. Since these types of investments are not directly aligned with KL Felicitas' mission, opportunities in this space are evaluated opportunistically. Given a choice between a Non-Social Component Investment and a Social Component Investment in the same asset class, KL Felicitas Foundation chooses the latter.

KL Felicitas defines Sustainability Investment as investments having a demonstrable focus on holistic sustainability, i.e., sustainability from an economic, environmental, social and spiritual perspective. KL Felicitas does not yet have a core set of simple and easily understood indicators and metrics to demonstrate this type of holistic sustainability, so it is using a set of discrete sustainability indicators in its due diligence process as described on its website.

Beyond Rational Man: Incorporating Behavioral Finance into Impact Investing

As impact investors seek to more tightly link investment and impact, behavioral finance can be a powerful tool to better define their impact investment thesis. Traditional finance uses models in which the economic agents are assumed to be rational. While this framework is appealingly simple, it has become clear that basic facts about markets are not easily understood within this framework. Behavioral finance is based on the alternative notion that most investors are subject to behavioral biases that can cause their financial decisions to be leseir finO:h:h:-m:tkjpojisim…fiit —5in“:-9l4-hnj:joj4…in9nj49ni:m-4og_-

communities become self-sufficient. We know from experience that both governments and markets can fail, and some of those failures present opportunities for impact investors. Altruism and narrow self-interest co-exist in most people. For most people there are limits to how much they are willing to sacrifice in order to help others. Some impact investors are willing to accept lower financial returns relative to risk in exchange for generating a social benefit, or what some might call a social return. Others are willing to engage in impact investing, as long as they do not need to sacrifice financial returns while pursuing impact objectives.

Behavioral finance has several implications when it comes to impact investing. First, impact investing adds value when it is able to counter some form of market failure. Second, investors will benefit if they understand the psychology which underlies a market failure. Third, the activity of impact investing will increase if investors become more comfortable with it. In his book *The Management Illusion*, Hersh Shefrin developed a checklist for managers to test whether they are subject to behavioral biases. This checklist is also useful for assessing impact investment opportunities. Below you will find examples of these behavioral biases. Each example is presented in three parts: a definition; diagnostic questions; and an illustration of the concept.

1. Overconfidence — Investors overestimate their ability and the accuracy of the information they have.

on the systemic overconfidence of investors — particularly the senior managers of large Wall Street investment banks such as Bear Stearns.[8]

2. Unrealistic Optimism — Individuals attach too high a probability to events favorable to them, and too low a probability to events unfavorable to them.

• *Are we looking at the world through rose-colored glasses?*

3. Representativeness — Investors place excessive reliance on

5. Availability Bias/Recency Effect — Investors overweigh readily-available information, e.g., by overstating recently observed events.

- *Are we placing too much weight on evidence that is in front of us, or easily recalled, and insufficient weight on information that is harder to obtain, or less easily recalled?*

Impact investors investing in alternative asset classes sometimes only review a very small slice of data to make their investment choices. Since it may be impossible for them to view and analyze the rest of the data, they may base their decision on this readily-available data only instead of completing the appropriate due diligence process.

6. Framing and Anchoring —

7. Mental Accounting — Individuals allocate wealth to separate mental compartments and ignore fungibility and correlation effects.

As outlined throughout this monograph, impact investing reflects the desire by investors to overcome the bias that financial assets dedicated to financial return cannot be mixed

Market Failures and Impact Investing

Impact investors have positive roles to play in addressing market failures, especially when it comes to dealing with issues involving public goods, externalities, and imperfect information. In this regard, consider the upcoming case studies in this volume:

- **Triodos Sustainable Trade Fund** — a guarantee fund that allows investors to support trade financing for certified fair trade and organic producers, and
- **Dial 1298 for Ambulance**

5 Investors should be aware that screened portfolio performance may or may not have the same performance as an unscreened portfolio when measured against a selected benchmark. Screening out certain companies also makes it impossible to take active ownership positions. Studies about the relationship between screening and investment performance are available at www.sristudies.org.

6 PRIs can be in the form of debt or equity and must be made with the primary intent to further program objectives. Following are the three criteria in the Tax Reform Act of 1969 section 4944 — used by the IRS to determine if an investment can be categorized as a PRI: The primary purpose of the investment is to advance the foundation's charitable objectives; neither the production of income nor appreciation of property is the primary purpose; and the funds cannot be used directly or indirectly to lobby for political purposes.

7 See Krugman, Paul, "How Did Economists Get It So Wrong?," *New York Times*, September 6, 2009 for a discussion of behavioral finance's role in the financial crisis.

8 Gladwell, Malcolm, "Cocksure: Banks, Battles, and the Psychology of Overconfidence," *The New Yorker*, July 29, 2009.

Once you decide to proceed with an impact investment strategy and have articulated an impact thesis, the process of translating this effort into a working portfolio begins. As outlined in the introduction, impact investors need to reframe their objectives to embrace the Genius of AND in order to move beyond the artificial dichotomy of financial return versus positive social and environmental impacts.

While certainly not an advocate of impact investing, David F. Swensen, the Chief Investment Officer of Yale University and the author of is our intent to illustrate how the impact investor, embracing the Genius of AND, can successfully develop and execute a rigorous approach to applying existing portfolio theory and investment discipline. First, we return to the cornerstone of traditional investment principles: asset allocation.

Asset Allocation Basics

Asset allocation is an approach in which investors spread investments over different asset categories, such as traditional stocks, bonds and cash along with what some call alternative investments (e.g., private equity, hedge funds, real estate and other commodity strategies). This allocation of assets hinges upon several factors, including investment objectives; attitudes toward risk and investing; desired return; age, income and tax bracket; time horizon; view on how various markets will perform in the short and long term; AND for the impact investor, desired environmental and/or social impact.

Asset allocation is based on the observation that different broad categories of investments have shown varying rates of return and levels of price volatility over time. By diversifying investments across several asset classes, investors may reduce risk and volatility while pursuing their return objectives. Generally, downturns in one investment class are expected to be tempered (or even offset) by favorable returns in another. Just as using different asset categories within a portfolio can reduce risk, an investor's choice of individual strategies or securities within an asset class can do the same. For instance, choosing stocks from different industries (e.g., automotive, high technology, retail or utilities) within the equity allocation can be less risky than investing all of the stock allocation in one industry or company.

Asset Allocation and the Impact Investor

Impact investors often find themselves questioning their ability to successfully execute an impact investment portfolio approach across their entire asset allocation. When starting this process, one of the first questions to answer is whether you are a financial first or impact first investor, or perhaps both.

For the financial first investor, sound economic principles that simultaneously satisfy social and/or environmental criteria serve as the drivers of opportunities in the portfolio construction process. In doing so, the investor can recognize and separate factors which serve as inputs to the financial component of the asset allocation process from those that do not. Although important, the potential social and/or environmental impact should not influence the financial risk attributable to a given asset class or investment in the asset allocation modeling process.

For the impact first investor, positive attributes of a desired social or environmental impact may outweigh pure financial considerations in the ultimate decision to allocate to a given investment. An investor may choose to go beyond traditional philanthropy and grants to employ flexible, patient capital opportunities that reflect the investor's desire to leverage social and environmental programs. Nonetheless, choosing the impact first approach should not dismiss the inclusion, evaluation and consideration of the financial risk associated with the proposed investment within the asset allocation framework.[10]

In some cases, an investment may satisfy both impact first and financial first investors. Opportunities that have high financial, social and/or environmental return are scarcer, but should be easier to identify once a clear investment thesis and theory of change have been developed. The impact investor's next step is to decide if they will fully embrace the Genius of AND by integrating impact investments into the overall portfolio allocation as opposed to a *carve-out*, a dedicated pool of capital allocated outside the portfolio. A *carve-out* approach may be appropriate for someone new to impact investing, but a committed impact investor should implement an integrated portfolio construction methodology, the integrated impact investor should evaluate and allocate investments within their defined investment policy.

If opting to use a *carve-out* approach, a risk profile, investment objective and target asset allocation should be developed for this portion of the portfolio. Although some investors envision replicating their overall asset allocation objectives within this segregated impact investment pool, there are often practical limitations in doing so. Asset size of the portfolio and potential cost of the investments are two such constraints. For example, the investment universe available to a $100 million portfolio is far different from that of a $2 million portfolio. Additionally, costs are typically higher for smaller or more retail-focused products. This higher cost may lead to other challenges which may ultimately limit the impact investor's ability to optimize for either the financial or social/environmental impact objectives they seek.

Whether choosing an integrated or

appropriate investment process is in place to treat each of these accordingly. For example, when adopting a financial first approach, capital market assumptions including forecasted return and risk should not be influenced by expected social and environmental impact. Inversely, the impact first investor should initiate the assessment process by validating a given investment's ability to meaningfully impact the desired themes and then validate the characteristics of the proposed economic model.

Furthermore, forecasting asset class returns, like any attempt to predict the future, is difficult. History provides the only measurable guide as to how asset classes behave under different economic environments. Unfortunately, focusing purely on the past to predict the future presents challenges when evaluating investments on both financial and impact dimensions. For example, five years ago, the long-term data on the risk-to-return ratio of real estate investments were attractive, and that has shifted. The investor should not only consider historical performance, but also current events, short- and mid-term forecasted economic activity, regulation, externalities and human psychology to formulate capital market assumptions. The relationship of risk versus return can be influenced not only by the characteristics of a given asset class exposure, but also by investment structure used to gain exposure to the asset class. For example, a senior debt investment with a large amount of subordinated debt below it has significantly reduced risk.

Measuring Financial Risk

Measuring or analyzing the risk associated with different investments enables the investor to determine the right mix of asset classes for a portfolio. Risk can be measured in a number of ways. One measure of risk is standard deviation, namely, how much an investment's price varies from its mean (average) return over time. The greater the standard deviation of an asset, the higher its highs and the lower its lows will be from its mean return. When considering two securities with the same expected return, a rational choice would be to buy the one with the lower standard deviation, because it carries less risk. This decision becomes more complex when the investor is faced with social and environmental considerations. These concepts of risk are not only applicable in the context of asset allocation modeling, but in the evaluation and comparison of similar investments. This notion is what is often referred to as "risk-adjusted rate of return." Investors, including impact investors, are wise to look at an investment's attractiveness by measuring how much risk is involved in producing the associated return. This is generally expressed as a number or rating. Liquidity is also a major factor in risk assessment.

Behavioral finance suggests some modifications to the traditional risk assessment framework described above by pointing out that psychological phenomena leave investors subject to systematic errors, which then are reflected in asset prices. The term sentiment is used to describe these errors. For instance, sentiment can cause some assets to be mispriced. Sentiment can impact the relationship between risk and realized returns. Notably, traditional measures of risk only capture the sensitivity of asset returns relative to the overall market, but not to sentiment.

Correlation: Diversifying Asset Classes to Reduce Risk

Combining different asset classes within a portfolio is called diversification. The goal of diversification is to build a portfolio with investment classes that offer different levels of risk and react differently to market events. By doing so, the investor strives to reduce overall risk and improve overall performance. Correlation measures the strength and direction of a linear relationship between the price movements of two asset classes over time. A well-diversified portfolio consists of asset classes that are not closely correlated to each other. Historically, an example has been stocks and bonds. On the other hand, if a portfolio consists of stock asset classes that include Large Cap, Mid Cap and Small Cap stocks, it is not well diversified because historically these stocks have tended to be closely correlated.

Asset Class Framework

This monograph categorizes investments by describing their role in a diversified portfolio. We are not advocating for a definitive language or approach to asset allocation. The following asset classes (which would need to be appropriately weighted given an investor's risk profile, spending needs, liquidity preferences and time horizon) represent the role an asset class may play in the development of a given portfolio:

- Cash and Cash Alternatives represent a portfolio's principal source of liquidity for meeting spending needs. The use of certificate of deposits and/or pledging cash accounts for guarantees alters this portion of the portfolio's liquidity and requires appropriate adjustments.
- Notes, Other Debt Obligations, Bonds, Absolute Return and Low Equity-Correlated Strategies may preserve wealth and/or generate income. The idea of low equity-correlation does not necessarily suggest exclusion of an equity investment. It is simply referring to an investment's relationship and performance relative to the broader global equity capital market asset class.
- Public Equity, Equity Long/Short and Private Equity assets serve to grow wealth through exposure to risk and strategies benefiting from global economic activity.
- Real Estate, Commodities, Timber and other Real Assets can protect a given portfolio from the erosion of purchasing power brought on by inflation.

Mapping Impact Themes to Asset Classes

Once you have decided on and documented an impact thesis and themes, you must identify opportunities to express these themes

Illustrative Landscape of Impact Themes

Asset Classes

Social, Environmental or Blended Impact Themes

	Stable Assets		Growth Assets
	Ca h Ca h ternat e	e Inc me	c t
C mate Chan e	reen an ep t	a - empt reen n	t e e at e creen n
ner		creene C rp rate n	chan e ra e n (
ater		C rp rate In ra tr ct re n	n t In e tment r t C e n n
C mm n t e e pment	C mm n t an C	rec re epa r	hareh er r t n
c a nterpr e		c a nterpr e Cre t	cr -Cap te c a C mpan e
ea th e ne			
ta na e e e pment	ra e nance arantee ep t	mart r th n c pa n	hemat c creen n
cat n	n e ep t arantee	Charter ch n	

in a given portfolio. The set of available impact investment options is determined by the breadth or narrowness of impact themes, geographic exposure requirements and other characteristics. It is important to consider that not all impact themes expressed through grants or other forms of philanthropy can be uniformly expressed in investible assets. We offer the preceding table as an illustrative example of how some common impact themes can be expressed across asset classes for a portfolio. When reviewing the matrix, you should note that each box represents not only a different financial risk reward characteristic, but also varying degrees of “impact” for the particular theme. This chart, of course, does not include *all* opportunities among exposures and themes, and as the field of impact investing expands, the opportunities across asset classes and impact themes will increase.

Applications Across Impact Themes

To illustrate, we will first examine the climate change theme as expressed in public equity screening versus private equity clean technology venture capital. An investor in a given fund or pool of large company stocks cannot account for the degree to which these companies mitigate their negative impact on climate or deliver innovative solutions to the problem. Although various methodologies exist to evaluate Environmental, Social and Governance (ESG) factors, most companies classified as Large-Cap tend to be diversified across multiple business lines. Each business group within the larger corporation may contribute to climate change by varying degrees. While the size, amount of readily available information and liquidity of a public-traded corporation may reduce financial risk, these same factors may make it more difficult to express a specific impact theme. In contrast, investment in clean tech venture capital may allow for greater identification and possible “purity” of the expression of the desired impact theme. A single private company or even a pool of companies comprising a venture capital fund will tend to focus their activities. This comes with the inherent additional financial risk associated with illiquid and/or early stage businesses.

It is important to note that the comparison of public equity versus private equity exposure would be irrelevant to the investor who does not have the risk appetite to be exposed to either asset class. For a conservative investor desiring to address climate change, the only appropriate financial first options may be green bonds or cash deposits in green banks. If a US foundation is utilizing PRIs, it may also consider environmental impact first options, such as a note/debt obligation to organizations providing capital for low carbon technologies and services in the developing world.

While the prior example contrasts impact among asset classes, this example focuses on the acceptable scope or degree of impact a given investment must have within the same asset class. When looking at water as a theme within public equities, many water funds hold General Electric (GE). Although GE is in the water business, it is estimated that water accounts for no more than 5% of its activities. However, given GE’s size, it is still one of the major players in this sector. The investor will have to determine the minimum level of acceptable direct impact. Some impact investors may be satisfied with 5%; for others it may be 25%, 50% or 100% of activities in the desired impact area.

Microfinance illustrates how one theme or strategy may be represented across the continuum of financial and impact considerations. Although microfinance is categorized as an absolute return/low equity correlated strategy in the matrix, a microfinance strategy can range from grants to non-profits to private/public equity in fully commercial microfinance institutions. Microfinance options are so numerous that one can narrow the impact objectives to focus on particular geographies,

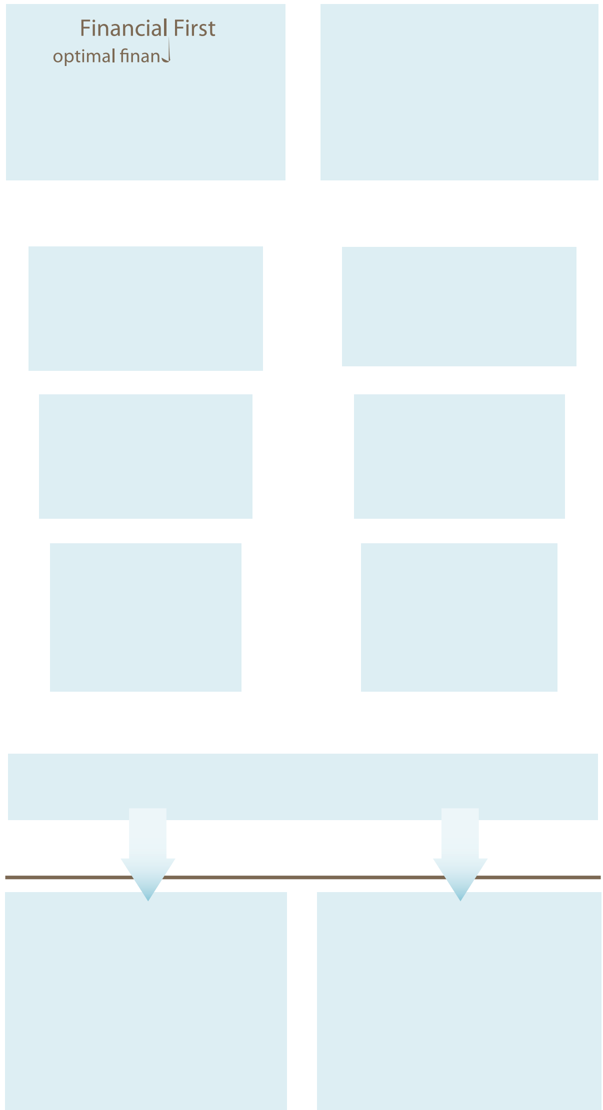
fiduciaries and other interested parties. Some important

Performance Benchmarks — documentation for the use of equivalent risk-adjusted commercial benchmarks for the financial first allocation. The development of standards is important for impact first investments. Examples include: equivalent commercial benchmarks with a discount factor; the use of an absolute return hurdle; or commonly available

AND set the following objective of exposure to its impact categories, targeting a 100% impact portfolio by 2012. As of August 2009, the foundation has successfully deployed 21 impact investments committing over 55% of its portfolio.

Portfolio Process Overview

Having developed an impact investing strategy as outlined in the


Financial First
optimal finan

Investor Intent

The first step is to clarify your motivation and intent as an impact investor. Is it to maximize profits with demonstrated social and/or environmental benefits? Or is the objective to seek out the optimal impact solutions for the societal and/or environmental challenges? Or is it both?

Based on the answer to this question, you need to develop the pipeline of investment opportunities. Once the portfolio objectives of financial risk/return and impact are clearly defined and articulated in the investment policy statement, internal investment and/or program staff, external advisors and consultants, fund managers and/or other resources will be able to identify the appropriate opportunities.

of the offering documents and operational assessment of the management company.

If the investment fails to successfully complete the financial due diligence process, but appears to exhibit meaningful social or environmental impact, it can be directed for consideration within the impact first process.

Assuming the proposed financial first investment has successfully completed the appropriate investment due diligence, an evaluation of the social and/or environmental impact should be completed. The extent of social and/or environmental impact should be articulated in the investment policy statement. You may choose to accept the impact metrics currently offered by the fund/investment, develop agreed-upon standards for

Impact First Investors:

If you are an impact first investor, the process should begin with the evaluation of the proposed social and/or environmental impact. As discussed in Chapter 8 in more detail, many methods exist to address this. If the proposed impact investment fails this process, it should be removed from consideration.

Investments satisfying the desired impact criteria move into the investment due diligence process. Once again, an appropriate level of quantitative and qualitative analysis should be conducted relative to the complexity, liquidity and risk associated with the proposed investment. Sometimes investors are quick to overlook the financial merits of an opportunity presenting compelling social and/or environmental impact. In doing so they may overlook the risk associated with a flawed economic model. This could ultimately result in the failure or the lack of scalability of the investment, negating the ability to achieve the sought-after impact.

At the same time, extenuating circumstances may cause a proposed impact first investment to fail the investment due diligence process but still meet the test of creating meaningful impact. In such cases, pure philanthropic capital may be considered to fund the initiative until it is more mature and able to accommodate impact investment capital.

Impact first investments satisfying the impact assessment and investment due diligence must then be considered within the framework of the investment policy. For US foundations qualifying the proposed allocation as a Program Related Investment (PRI) and counting it as a portion of the required spending, simply noting the allocation to the investment policy should suffice. This is a result of the PRI being a substitution of the foundation's greatest risk capital — grants — something that would currently be captured as spending within the investment policy and portfolio-modeling framework.

For investors not able to qualify the proposed investment as a PRI, compliance with the guidelines established by the investment policy should be adhered to. As before, if current constraints or portfolio holdings prevent compliance with policy, the investment will be considered for future allocation. The investment could be implemented once the limiting factors have been removed and any updates to the analysis are completed.

Although not illustrated in the process diagram, you should note that impact funds, investment structures and hybrid enterprises might offer tranches that fit within financial first, impact first and philanthropic options. What may start as the exploration of an opportunity in one area may quickly find its way to another or may even be satisfied with capital from multiple funding sources. In either case the appropriate process should be applied relative to the role and purpose of the available capital.

By harnessing the Genius of AND, we believe you can not only apply financial portfolio theory, but can also benefit from applying the discipline of asset allocation, investment policy statements and a rigorous, well-defined portfolio process.

---

9 Swensen, David, *Pioneering Portfolio Management: An Unconventional Approach to Institutional Investment*, New York: Free Press, 2000.

10 Given the specific treatment under US tax law of Program-Related Investments made by US foundations, PRIs may be considered a portion of the required charitable distribution rather than the asset allocation. By substituting the greatest risk capital of the foundation — that of a grant — and modifying the actual spending policy, PRIs need only be noted within the target asset allocation and portfolio investment policy.

Building the Transaction Pipeline

Once you have defined your impact themes, developed your impact investment policy and an appropriate asset allocation, the challenge shifts to finding and executing impact investment transactions. Your success will depend on your search efforts, (GIIN), More for Mission and impact investment collaboratives in which impact investors share expertise and co-investment opportunities. (See www.rockpa.org/impactinvesting for a listing of resources.) While reviewing impact investment opportunities, also keep in mind that supply and demand need to co-evolve in this market. Investors need to understand how they can assist in the mentoring, incubation and acceleration of impact investment opportunities to avoid a market in which the available capital exceeds the available supply of high-quality deals.

Direct Versus Funds Strategy

The decision to make direct investments and/or to utilize funds and other types of intermediaries is a critical step in the execution of your impact investing strategy. The decision to utilize a direct and/or fund-driven approach may be a function of your impact themes and desired level of engagement in the investment process. For example, in the impact themes of affordable housing and microfinance, there is a wide range of funds through which an investor could invest. In other sectors investors may have to work to create and seed such funds or look to investment opportunities with secondary or tertiary effects related to a primary impact theme (e.g., the impact on health through a microfinance investment). The due diligence process will differ between direct investment and funds as well.

Calvert Foundation invests in non-profits with proven track records that demonstrate strong management, effective operations, good financial performance and sound capitalization. Borrowers are subject to a rigorous due diligence process. Calvert Foundation has designed Notes to be suitable for all classes of investors, from large institutions and high net-worth individuals looking to leverage a portion of their investment portfolio towards community development initiatives, to retail social investors seeking to align their investment decisions more seamlessly with their values. Notes are a taxable, low-volatility fixed-income product. Notes provide accessible capital to community development organizations around the world while offering investors a compelling blend of social and financial return; therefore they are a suitable addition to both investment portfolios and philanthropic portfolios.

RSF Donor-Advised Funds Investment Portfolios
RSF's goal is to identify and invest in the most direct opportunities available to support innovative funds, institutions and projects, reducing unnecessary levels of intermediation, while also meeting diversification, risk and return criteria. Social impact is measured by a combination of quantitative and qualitative factors with a focus on the outputs of the investments such as the number of affordable housing units financed, low-income mortgages made and environmental impacts achieved.

Current Universe of Impact Investment Funds

To aid current and prospective impact investors and their advisors with developing a framework for evaluating investments, we have provided an “Impact Investment Profile” template on page 84 which can be customized to evaluate impact investing opportunities. Using this form, we have included three Impact Investment Profiles in this chapter. Additional Impact Investment Profiles, which were produced over the course of our research, have been made available at www.rockpa.org/impactinvesting.

The profiles featured in this chapter and the case studies in the following chapter are representative examples of the more than 100 funds and enterprises our team researched for this publication. We have evaluated and documented each example using the same criteria for social and environmental impact

Methodology Used

Impact investment opportunities have social/environmental and financial dimensions. Our template is careful to highlight both aspects of the funds and enterprises. The profile has four main parts: a table with a snapshot of the proposed impact and investment; an overview of the impact to identify the problem/need; a description of the market; and the investment's proposed response. Furthermore, the language utilized in completing the table of the profiles has been aligned with the taxonomy developed by GIIN for their upcoming database.

The final section presents basic information on the fund or investment, including the appropriate contact person. This information was obtained from the supporting documentation of profiled funds. In most instances, funds were easily categorized in a particular asset class. In some cases, however, funds made both debt and equity investments and thus had characteristics of more than one asset class. In such cases, the funds are simply noted as Multi-Asset. Although behavioral dimensions of the funds and enterprises are not addressed on the profiles, the information presented on the fund or enterprise allows a prospective investor to evaluate different behavioral elements of the investment opportunities, illustrating why certain classes of funds and enterprises have not historically received funding or attention from investors.

The content in these profiles was derived from information provided by the profiled investment opportunities and our team.

Impact Investment Profile

1. Impact Overview

a r 2em ee:

1. Impact Overview

a r em ee : e e p n mar et ac enterpr e that pr ce
c ean ta na e ener an ener eman ten tpace

1. Impact Overview

a r em ee : ta na t cha en e re at n t ne
nc e the ep et n nat ra re rce the a re c mpan e
t a e ate m n t r the r c rp rate c t en h p pract ce
c mpan e part c pat n n n tr e that er r ntr ce
ne at e e terna t e t c et an the c nt n e e rt nee e
t enhance r p ace er t

e cr pt n the ar et: e er er erman e ect m - an
ar e-cap t c t p ca tra e n e chan e

c In e tment e p n e t ar et: he n h h ht c mpan e
that e t appr ach e ernance an c rp rate
c t en h p ncrea n the mp rtance the e cr ter a r
n e t r an n t rn n n a t p t e c a chan e thr h
ar e c mpan e C mpan e h em n trate ea er h p n the
area en r nmenta mpact r p ace pract ce c mm n t

Impact Investment Profile

Impact	Investment
Approach: Financial First	**Asset Class:** Private Equity
Theme: Environmental	**Structure:** Fund
Sector: Green Technology/Cleantech	**Status:** Actively Raising
Sub-sector: Multiple	**Geography:** Europe

1. Impact Overview

a r em ee : he e ect c mate chan e c nt n e t mpact the en r nment a p p at n r th c nt n e t e ncrea e ener eman nat ra re rce ep et n threaten c n ent na ener pp an mpen n ernmenta re at n an ncent e enc ra e n e tment n ta na e ener pr ct n

e cr pt n the ar et: the ear a pter r pe an entrenche a t- e e p n mar et th n -term re at n r pe ha a tpace ther re n (1 n e r er a t ta n 2 m te c mpet t n r ea t ht pr c n c p ne an ar e ca e mar et er a tr n pr ate e t en r nment

c In e tment e p n e t ar et: n t pr e r th e t an act e pp rt t techn c mpan e n a ternat e rene a e ener re rce e c enc an en r nmenta er ce techn n an e ta he an ncrea n eman n r pe

2. Fund/Investment Information

a ana er ame: ent re (c m

cat n: n n

c n ame: C eantech r pe II

rm : 1 m n e r acr three n (e c C eantech r pe II

e trate : C eantech r pe II tar et n 2 m n e r n c mm tment

trate e cr pt n: C eantech r pe II a pr ate e t n
that n e t pr mar n r pean e pan n ta e c ean-tech
c mpan e th c mmerc a pr en techn act e
mana e t p rt c mpan e e era n t pr en trac rec r
pr n trate c ne e e pment an nanc a
tr ct r n pp rt

e In a an ac r n: ha een n
ne e nce 1 th the partner r n t ether r an
a era e ear amer a t C an c - n er ar :
arcent r an r ner rmer r an an ,
e n ch ert partner an c - n er ar : rce
artechn an tr n echn e he Car n e tra C mpan
an p rmer r an an , at partner
ar : C r ce n rmer hea re earch at n er
ne ta na t In e , nth n ar : r ant e
C n her -C mmerce c an a han ne -
n r e acr a an the e a t

h rt er cat n: ar r pm p c a

Generating deal flow is an ongoing and evolving process. Investment managers, product designers, intermediaries and often impact investors themselves are continually developing offerings to harness the scale and power of capital markets to deliver solutions to the social and environmental challenges faced by society. These efforts are not only underway in the boardrooms of the traditional financial or philanthropic centers, but are occurring at the grassroots level throughout the developing world, where many of the desired “impact” objectives are felt in real time. This results in deal sourcing being a global effort as impact investors seek opportunities to satisfy their desired levels of financial return AND social/environmental impact.

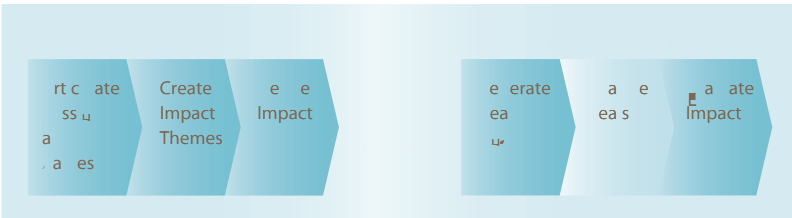
Impact In e t n C n erence

Impact n e t r ee n n e tment pp rt n t e th ht ea er h p peer earn n an c a rat n ene t r m a r n n m er e cate c n erence an e ent amp e h ch ha e em n trate repeate the a t t c n ene a ence an er n ht an pp rt n t e acr the pectr m mpact n e t n nc e:

I a er et r at na C n erence
(pr ma er net c n erence
a e ct n Impact In e t n C n erence er e
(ta eact n r mpact c m
I C n erence (t c n erence c m
C nn a C n erence (c a cap ta mar et net

Chapter :

Analyzing Deals



Due Diligence of Impact Investments

Due diligence is your organization's research and investigation of impact investment opportunities. A first step in this process is to answer threshold questions such as:

- What is the impact investment thesis for this opportunity and how does it further specific impact goals?
- Is this a financial first or impact first investment?
- Who are the principals involved in the investment?
- Does the transaction leverage other sources of capital?
- What are the impact and financial risks and how are they distributed?
- Will this investment enable a project to happen that otherwise would not?
- Are there behavioral finance aspects you should consider?
- Does the investment raise reputation or policy issues?
- Where would this transaction fit in your overall asset allocation?

After an initial review, you and/or your financial advisor will complete a full review of the financial statements or offering documents and other relevant organizational materials as well as project-specific documentation such as projections and business plans. For some impact investment opportunities, it is possible to purchase “off-the-shelf” financial analysis from third party providers. Keep in mind that structured investments such as project financings, loan funds or investment in private equity funds will require a more customized financial analysis. A clear assessment of the quality of the management team is a key element of the due diligence. When investing in an intermediary, it is necessary to assess the fund manager’s ability to find portfolio companies and projects that fit your impact and investment goals. You may look to a fund manager’s previous track record with placing and exiting investments as one indicator of future success.

In general, financial advisors and other investment intermediaries will be more comfortable assessing the financial risk of the investment. The due diligence process for impact investments also needs to consider potential “impact risks” and their mitigation. Careful consideration of the mission-alignment of the management is crucial. So too is attention to the governance structure of the fund or company and how it will inform the inevitable trade-offs that successful impact investments encounter between opportunities for financial gain and impact. For direct investments, this additional due diligence can add substantial transaction costs. The deeper engagement by investment principals which this approach necessitates should be seen as more than simply an increase in research costs. Engagement with the management team often provides additional motivation and reward for the impact investor as well as for the investment. Options are also available to reduce transaction costs, most notably by investing through an established intermediary that aggregates investors’ capital, such

evaluates the social entrepreneur's intention for beginning the business, potential exit strategies, and plans for improving production and supply chains from a social impact perspective. The Credit Committee reviews first the intention(s) of the entrepreneur and the social impact to ensure alignment with RSF's values and strategic plan, and then the underwriting is reviewed. If approved, RSF has a board-approved Loan Authorities Matrix for obtaining the required signatures for closing. Day-to-day management of loan clients is the responsibility of the individual relationship managers.

c n t Inve tment r ce

Due Diligence Case Studies

At the core of the due diligence process is the analysis of the underlying impact investment business models and risks. We

Background Brief

r ta na2e ra e n (pr e tra e nanc n r
cert e a r tra e an r an c (C pr cer he n pr e

n er e e pe a e ne the C ten the ha e n cant
tac e t re n n e tment nc n n er e e pe r
na e ate an n an ec r t e n tr re at n n ta e r
h h e e n at n an n cant re n c rrenc r

In the event e a t n er n rr er t the the e
are hare an char e t the p e e ep t (arant r he
r an er the pa t e ear acc r n t r n

Challenges and Opportunities

he act te the r ta na e ra e n a th an tra e nance n e tment trate are e p e t m t p e r r ana e the r a c ate th pr ct n n n- e er e t r tra e p te an e a t n er t name a e n c n tr ct n the r an p rt

he arant r are e p e t th r nherent n arm n n e e p n c ntr e thr h a an nterme ar In the e ent a nat ra a ter r a p r cr p e e p rt t merchant e re ce an n t rn the r pa ment t e re ce an the e char e pr rata t arant r th h th r nc rre ate th ther mar et-re ate r t h ch arant r e n rma e p e th e p rt r can e n cant r ha cce m t ate the e cha en e e t the r e ten e e per ence an cce trac rec r n the area m cr nance an tra e nance a em n trate the r mana ement - r n r en n at n an the r a r hare n er the pa t e ear acc r n t r n t e ha e een rep rte am nt n t e than 1 the a era e am nt an r e

arantee th r ta na e ra e n repre ent e p re t an ca h a cat n ep t are e r - en m nate h ch er an e ement re n e chan e r an ra e n a a a

Triodos Sustainable Trade Fund — CASE STUDY cont.

Conclusion

r the mpact n e t r ee n t ma m e the c a an en r nmenta ene t pp rt n tra e nance r a r tra e cert e an r an c the r ta na e ra e n er a c mpe n n e tment pp rt n t t na n at n ma c n er a n appr pr ate an a cat n t the n a a r ram- e ate In e tment e t the n mpact r t c

he n rmat n pre ente here n ha een prepare r n rmat na p rp e n an n t an er t r e r a c tat n an er t r e an ec r t r n ntere t he er n c rc ar each ec r t r the re pect e n c n ent a er n mem ran m c nta n mp rtant n rmat n c ncern n r an ther mater a a pect the n e tment an m t e rea care e re a ec n t n e t ma e

th h the n rmat n pre ente here n ha een ta ne r m an a e p n rce e e e e t e re a e n repre entat n r arrant e pre r mp e ma e a t the acc rac r c mp etene that n rmat n a rance can e en that the n e tment ect e e cr e here n e ach e e

Background Brief

a 12 r m ance (a 12 pr e a pr ate re a e r n -the-c c emer enc am ance re p n e r re ent n e ect c t e th n In a It t e a t ere pr c n cr - m e t en re acce r a re ar e a t t pa a e n the cce t m a n t at e a 12 pr nc pa ha e e n r n t er ce t the t p 1 c t e th p p at n er ne m n th n In a

Vision and Mission

m ba cat n a 12 r t r t a c t 1 m n
pe p e et t h t r ca ac e an re a be amb ance r emer enc
me ca re p n e er v ce r v ate car a t r c ha ta r v an
amb ance th n me ca e pment r tra ne techn c an
ere t p ca e t ta e pat ent t a h p ta th t the bcene t
me ca per nne the e amb ance ten en p nct n n
n a heard e he p r er pr p rt nate r m the ac
the e er v ce beca e the ace reater tran p rtat n cha en e
an are e a be e t pa r r t a 12 the c ncept n e
n mber ca n r an amb ance er v ce a n ne tent the
re p n e t me r ther er v ce a t p ca v er h h, the e
er v ce ere n t pr e na mana e , an there ere n
c mm n cat n n bet een the amb ance an the h p ta

t r ca an c n t t t na the pr v n p b c hea th care
the tate v ernment re p n b t e v er e c e r m
b th the pre v ent v e care an h p ta care v n th n the hea th
care tem an r pe n er a ter ana ement (epartment
e v en e h c rrent n t a pr r t er v ce r the
v ernment t na amb ance er v ce n t c rrent c v ere
n er hea th n rance p an

Business Model

a 12 r mb ance pr p e t a re the nee emer enc
me ca er v ce n the t p 1 c t e n In a b b n a eet
amb ance mana e b a 2 ca center that re p n a ter t
emer enc ca c t e than the c mpet t n an pr v e a
c eaner better e ppe an better mana e er v ce a 12
er t t pe amb ance : a c e pp rt an v ance
e pp rt amb ance are c mp ete e ppe (ct n
mach ne re c tat n t en an an v ent r emer enc
me c ne he v ance e pp rt amb ance a er
e br at r C car ac m n t r an p rta b e v ent at r
amb ance are cre e th a parame c r v er an a he per tra ne

pr ram cert e the mer can eart c at n an e
r re ter an p ta

Tiered Pricing Cross-Subsidy Model

a 12 ne m e a e n t ere pr c n th cr -
e me c t mer pa e than the mar na c t
pr c n the e r er ce h e ther c t mer pa h her
than the mar na c t[11] p rt n the re en e enerate r m
e n r er ce t c t mer a e t pa the pr ce are
e t e th e na e t c er an r part the c t
er ce a 12 emp a n pr ce ca e: ea th er
c t mer e ect n the m re e pen e h p ta pa the rate
r an am ance r e h e the p r rece e a eep c nt p
t r ree er ce

a 12 ne m e tar et a rat pa t ree am ance
tenreerat m a c a e a ee a p a a
pa a er cec mc n a e a r ar cec a e th a

three ear a he e c ntract a a ne re en e tream t a 12 er an a e the er ee an nat n r m c rp rate p n r r the p rcha e am ance

r th r er re e ant t the cce the a 12 m e nc e: ncrea n c n mer a arene re t n n a nee r a e ran e h h a t emer enc me ca care, r th c mm n cat n techn an n ra tr ct re, an entr pr ate hea th n rance c mpan e t chan e the ace hea thcare er ce

e en e r er nc e: tr p per a per am ance, pr ce char e per tr p, an pr p rt n emer enc er ce t a c er ce

C t r er nc e: e h ch c n t t te m re than re en e , eprec at n h ch rm a n cant part era c t an pre ent at a t t ta re en e (h e er eprec at n c t re ce t 11 t ta re en e 2 11 12 a m t the cap ta e pen e e am rt e , an pa r am ance-re ate a ar e acc nt r a t 21 t ta re en e 2 11 12 (c rrent a t 2

Financial Returns

e en e ere $1 m n n 2 an are e pecte t reach $3 3 m n n 2 an $ 3 m n n 2 1 [12] he nanc n nam c r a 12 n e p rcha n the am ance thr h the e $1 m n n e t ta ne n 2 r m c men n a n n-pr t a ent re n an ne the r e n e t r c men n ha a n cant m n r t e t p t n n t a ea th Care m te parent c mpan a 12 a 12 r n n a ec n r n n n c men n n e t a t na n t ma nta n t h n e n e t r are e pecte t h a m n r t ntere t an a 12 n er are e pecte t h e than the c mpan

Social Returns

h e the er ce ma nee e r etar pp rt n r ra area a 12 appear t e capa e a re n the emer enc me ca er ce mar et nee n r an In a e pec a n the t p 2 c t e n In a 2 the er ce a 12 are e t mate t e ere ree c t r at e rate th n e tment pr e an pp rt n t t e ten a t hea thcare t a n cant p rt n the r an p r n In a (e t mate t e l 2 t m n pe p e n m a a ne he r t a h h- a t a r a e e- a n am ance net r n m a h create a reat ea a e r c n mer n term pr n a e ate hea th care n a t me ta na e an c t-e c ent manner

Challenges and Opportunities

a nta n n the pr ecte c t mer m e a cha en e a 12 nera e there a prec p t r p n the percenta e -pa er ce t the e pa p n r can p tent a re ce th mpact a r p n pa n c t mer a n cap ta t e pan t perat n ma e a cha en e a 12 ee t ra e cap ta r m rce that e the t re en e a c ate th the t ere pr c n cr - m e a re c n the pr pect e pr ta t the c mpan n ther p e cha en e c mpet t n that m ht tar et the h her- nc me p rt n a 12 c t mer a e

ma r cha en e ahea e cat n the c t mer a e en th e c ent tem n p ace a 12 nee t e cate pe p e a nc me e e a t the r er ce an the a anta e n an am ance he c mpan e e p n mar et n campa n t ra e a arene a t the mp rtance ca n an am ance n an emer enc an e ect n eha ra chan e n the p p ace (e a e a e a e a r an am ance a n a 12 te eph ne n m er ea er t reca r n emer enc e a a h h pr r t

Behavioral Finance Reflections

As previously discussed, the behavioral approach emphasizes investors' reliance on heuristics, or rules of thumb, because they do not act in a fully rational manner. Some key issues impact investors should consider when researching an impact investment include: understanding their own heuristics; being able to separate their own bias from the facts as presented; and being able to gauge if the facts as presented are fully transparent.

In the case of Triodos and Dial 1298, two investors seeing the same set of facts might come to two different conclusions. One investor might see the impact metrics as representing the best possible case, while a second investor might feel the metrics are depicting only an average scenario. What one investor may see as an opportunity in an emerging market, another may see as too high a risk to warrant an investment.

Is there a market failure stemming from representativeness bias in the Triodos and Dial 1298 business models? One could make the case that representativeness bias explains the existence of both market opportunities. This bias could also stem from excessive reliance on stereotyping, for instance, leading to a general belief that poor people are unwilling or unable to repay debt or cover ambulance fees.

11 See the University of Michigan's case study on Subsidies in Base-of-the-Pyramid Ventures, which includes a section on Dial 1298 for Ambulance: http://www.globalens.com/casedetail.aspx?cid=1428767

12 Dollar figures based on an exchange rate of 48 INR to 1 USD.

Defining and Measuring Impact

As an impact investor, you are seeking the best opportunities for achieving impact within specific impact themes. With this goal in mind, how can you capture the impact of your investments and use this knowledge to drive your future strategy and investment decisions? Impact investors who are philanthropists will understand the challenges of measuring the impact of their grantmaking and recognize that similar challenges will exist with measuring the social and/or environmental benefits of impact investing.

To better understand how your impact investments are creating social and/or environmental impact, it is essential to be very clear about measurement. A key notion is to differentiate outputs from outcomes. Outputs are results you can measure or assess directly. For example, outputs for a homeownership

effects. While impact should be measurable based on clear outcome metrics and comparable across social enterprises, we should be aware of the challenges of aggregating outputs across impact themes and overemphasizing impact themes which generate easily quantifiable outputs compared to more qualitative themes.[14] Impact investors seek to create impact assessment systems relevant to their missions while also trying to create reporting that can be compared to other investors' performance. On the financial side, setting clear benchmarks for each asset class is standard practice. Establishing the appropriate benchmarks on the impact side is not yet standardized.

Core Beliefs for Impact Assessment

Given the complexity of impact assessment, it is useful to approach this with some core beliefs. The following was developed as part of a recent McKinsey & Co Discussion Paper.[15] It focuses on foundations, but the principles apply to other impact investors as well:

- Hear the constituent voice;
- Exercise rigor within reason;
- Assess not for assessment's sake;
- Design assessment and strategy together;
- Don't let assessment sit on a shelf;
- Collaborate, don't dictate;
- Build off and build up;
- Borrow, don't reinvent; and
- Foster learning culture.

RSF Social Finance approaches the question of social impact through a holistic framework derived from the Balanced Scorecard methodology. This approach provides a roadmap for

instilling explicit, values-based strategies and evaluation at every layer of the organization, from day-to-day business execution to client relationships to its contributions to the overall field of

social service, it can present problems in comparing social returns based on the capital amount required to produce those returns. The basic version of this tool calculates among bundles of Ds ons.

There are a number of initiatives under way to address the infrastructural gaps for impact assessment. In this regard, the Impact Reporting and Investment Standards (IRIS) initiative of the Global Impact Investing Network seeks to move toward standardizing the measurement and reporting of social and/or environmental impact investment. Developed by a group of leading impact investors (with support from Deloitte and Touche, PriceWaterhouseCoopers, Google.org and B Lab) and piloted with investment funds and companies around the world, the IRIS standards seek to establish uniform definitions of terms for social impact reporting (just as the GAAP standards do for financial reporting) and to equip fund managers and direct investees to adopt these standards. IRIS will also aggregate social performance data and release benchmarking reports that enable impact investors to compare investments against their peers — a capacity that proved central in the growth of mainstream venture capital and private equity.

The field of impact measurement remains very much in flux with much innovation and a lack of industry-wide standards. However, impact investors are currently deploying meaningful approaches. We anticipate that impact evaluation will continue to be an area of rapid consolidation and progress.

---

13 For additional research on impact measurement, please see the *San Francisco Federal Reserve Community Investment Review*, Summer 2009 (http://www.frbsf.org/publications/community/review/vol5_issue2/index.html).

14 See Kramer, Mark and Sarah Cooch, *Investing for Impact*, FSG Social Impact, Boston, 2006 for an analysis of impact measurement — particularly the integration of qualtitative measurements.

15 "McKinsey's Approach to Learning for Social Impact," McKinsey & Co., Discussion

We hope our monograph has inspired you to move beyond the Tyranny of OR and apply the Genius of AND. Impact investing has emerged as a viable and growing discipline — across asset classes and impact themes. All types of capital can and must play a central role in moving impact investing forward. Many high

Rigor Matters

Impact investing is not charity. It requires and demands every bit of the same disciplined approach currently being applied to traditional investing if it is to succeed. Adding social and/or environmental criteria to existing rigorous investment evaluations may actually improve the quality and output of investments. Investors no longer need to assume that a discount be taken on their returns in order to align their investments with their impact objectives. Aligning investments with impact AND utilizing a disciplined approach is achievable.

Investment Management Best Practice

Impact investing can be done within the established parameters of investment management best practice. Impact focused financial advisors, intermediaries, investor networks and collaboratives are emerging in greater numbers. In light of the market turmoil of 2008, investments with a double or triple bottom line may be the antidote to growing mistrust in the market place and perhaps part of a new ‘best practice’ paradigm. While the impact investment market remains fragmented, we expect the market to grow dramatically as large asset managers enter the impact investing space.

These managers will be driven not only by clients who are increasingly demanding social and/or environmental metrics as part of their investment strategies, but also by their own values and the realization that impact investing makes good investment sense.

Impact Investment Opportunities Abound

Investment-grade impact investments are experiencing rapid growth. Global intermediaries are playing a key role in building demand for capital. These same organizations, with the help of capital or capital is competing for product. And without open channels between all interested parties, we risk missing important innovation that could help move impact investing from the sidelines into the mainstream investment market.

Understand Inefficient Markets and Use Impact Investing to Address Market Failures

Impact investing benefits greatly from consideration of behavioral finance — not only in the assessment of investment opportunities but also in its evolution. Awareness of behavioral finance augments our understanding of inefficient markets, providing a subjective lens through which we can further evaluate a typically analytic process. Historically, impact investing has suffered from overconfidence on the part of the impact investing community, but also lack of confidence from the traditional investment community. Finding an appropriate middle ground will help move this field forward. Representative bias is difficult to tease out, but doing so can help the investment professionals provide more objective analysis. Acknowledging that perceptions of trust, honesty and morality are significant factors influencing our investment decision-making will go a long way to co-create and sustain this brave new world.

ppen 1:

Impact Investment Profile Summary

The following is a list of impact investments profiles available at www.rockpa.org/impactinvesting, which were prepared in conjunction with this monograph. They are meant to serve as an illustrative example of impact investments available in the market place today and by no means represent a comprehensive list of the industry. Furthermore, additional profiles will be added online as they are completed. Please visit the site periodically for updated information.

cce Cap ta
c men Cap ta ar et
mer can er ent re n II
r a Cap ta
C Chan e ran rmat e ner an ater a n
Ch na ner c enc n
C mate Chan e r pert n
C mm n t Cap ta ana ement
C ntact n
cr nance n I
C e p e anet te
c nterpr e n II
reen Car n eh c e
e In e tment n
reen pace e e pment
reen a ree arm n
ea thp nt er ce a
h ater a n
I3 n
I I n
I n r nmenta ar et
Inn ht ent re n
n C t e Cata t n
n re t C mm n t e
n e e C mm n t In e tment In t at e
me re t n III
n am cr nance r ca n
C Cap ta Impact
e er er erman c a e p n e t
c n t
anet a tat
e mart r th In e tment n t Cap ta
e - e p e era Cre t n n
h re an Capac t an r ram
c a t c chan e
thern anc rp
mm t ater t n
ta na e ater trate er an e n III
erama r re tr r ect
aterCre t In t at e
ater r th t n
C eantech r pe II

See important disclaimer information on inside back cover.

ppen 2:

Selected Bibliography

For our comprehensive bibliography please visit www.rockpa.org/impactinvesting

Anderson, Miranda and David Gardiner, *Managing the Risks and Opportunities of Climate Change: a Practical Toolkit for Corporate Leaders*, Boston, MA CERES, 2006.

Akerlof, George A. and Robert J. Shiller, *Animal Spirits: How Human Psychology Drives the Economy, and Why It Matters for Global Capitalism*, Princeton: Princeton University Press, 2009.

Bayon, Ricardo, Amanda Hawn, and Katherine Hamilton, *Voluntary Carbon Markets: An International Business Guide to What They Are and How They Work*, 2nd ed., London: Earthscan, 2009.

Belsky, Gary and Thomas Gilovich, *Why Smart People Make Big Money Mistakes And How To Correct Them: Lessons From The New Science Of Behavioral Economics*, New York: Simon & Schuster, 1999.

Bernholz, Lucy and Lisa Richter, *Equity Advancing Equity: How Community Philanthropy Can Build Racial and Social Equity through Mission Investing*, Blueprint Research & Design and GPS Capital Partners LLC, September 2009.

Bishop, Matthew and Michael Green, *Philanthrocapitalism: How the Rich Can Save the World*, Bloomsbury Press, 2008.

Bolton, Margaret, *Foundations and Social Investment: Making Money Work Harder*, London: Esmée Fairbairn Foundation, October 2005.

Bugg-Levine, Antony, "Impact Investing Bold Models to Drive Development at Scale," *Beyond Profit*, Intellecap, May/June, pg 17-21, 2009.

Carlson, Neil, *Assessing and Managing PRI Risk: Nothing Ventured, Nothing Gained*, New York: GrantCraft Guides, 2008.

Cooch, Sarah, Mark Kramer, Fi Cheng, Adeeb Mahmud, Ben Marx, and Matthew Rehrig, *Compounding Impact: Mission Investing by US Foundations*, Boston, MA: FSG Social Impact Advisors, 2007.

Deringer, Freshfields Bruckhaus, *Legal Framework for the Integration of Environmental, Social and Governance Issues into Institutional Investment*, UNEP Financial Initiative, 2005.

Dietel, William M., *Mission Stewardship: Aligning Programs, Investments, and Administration to Achieve Impact*, New York: The F.B. Heron Foundation, 2007.

Elkington, John, and Pamela Hartigan, *The Power of Unreasonable People: How Social Entrepreneurs Create Markets That Change the World*, New York: Harvard Business School, 2008.

Emerson, Jed and Joshua Spitzer, *Blended Value Investing: Capital Opportunities for Social and Environmental Impact*, World Economic Forum, 2006.

Emerson, Jed, Joshua Spitzer and Jacob Harold, *Blended Value Investing: Innovations in Real Estate*, Oxford: Skoll Centre for Social Entrepreneurship, 2007.

Godeke, Steven, and Doug Bauer, *Philanthropy's New Passing Gear:*

Kiernan, Matthew J., *Investing in a Sustainable World: Why GREEN Is the New Color of Money on Wall Street*, New York: AMACOM / American Management Association, 2009.

Krosinsky, Cary (editor) and Nick Robbins (editor), *Sustainable Investing: The Art of Long Term Performance*, Earthscan Ltd., 2008.

LaVoie, Valerie and David Wood, *Handbook on Climate-Related Investing Across Asset Classes*, Institute for Responsible Investment at the Boston College Center for Corporate Citizenship, 2009.

Passoff, Michael, *Proxy Preview 2009: Helping Foundations Align Mission and Investment*, As You Sow, San Francisco, 2009.

Segerfeldt, Fredrik, *Water for Sale, How Business and the Markets Can Resolve the World's Water Crisis*, Washington, DC, The Cato Institute, 2005.

Shefrin, Hersh, *A Behavioral Approach to Asset Pricing*, Burlington: Elsevier Inc, 2005.

Shefrin, Hersh, *Beyond Greed and Fear, Understanding Behavioral Finance and the Psychology of Investing*, Oxford: Oxford University Press, 2002.

Stetson, Anne, and Mark Kramer. *Risk, Return and Social Impact: Demystifying the Law of Mission Investing by US Foundations,* FSG Social Impact Advisors, October 2008.

About the Authors

STEVEN GODEKE

Principal, Godeke Consulting

Steven Godeke is an independent investment advisor who works with foundations, corporations and non-profit organizations to integrate their financial and philanthropic goals. Steven advises his clients on the creation and execution of impact investment strategies across asset classes and program areas. His services include due diligence, structuring and negotiation of impact investments and portfolio performance measurement. Steven is co-author of *Philanthropy's New Passing Gear: Mission-Related Investing — A Policy and Implementation Guide for Foundation Trustees*, published in 2008 by Rockefeller

RAUL POMARES

Managing Director, Springcreek Advisors, LLC

Raúl Pomares is a Managing Director of Springcreek Advisors, where he serves as the principal investment advisor to select family offices, foundations and endowments. Prior to joining Springcreek, Raúl served as a Portfolio Manager with Guggenheim Investment Advisors, where he developed integrated multi-manager portfolios for institutional and high net worth clients. In particular, Raúl applied his expertise across a broad range of impact investment themes to create an integrated manager research and portfolio construction methodology for investors. Before joining Guggenheim Partners in 2006, Raúl co-founded a boutique wealth management firm where he directed client services. He has also served as an investment advisor, international private banker and consultant on behalf of global financial institutions and private investors.

Raúl is an internationally recognized speaker and contributor to numerous publications on innovative investment solutions for return-oriented investors seeking measurable impact. He serves as Mentor – Capital Markets, for "The Global Social Benefit Incubator (GSBI™), the signature program of Santa Clara University's Center for Science, Technology and Society. Raúl received his degree in international business management from the University of San Francisco.

ALBERT V. BRUNO

William T. Cleary Professor, Leavey School of Business, Santa Clara University

Albert V. Bruno is the William T. Cleary Professor at the Leavey School of Business at Santa Clara University, where he has held a variety of administrative positions as well as founding the Center for Innovation & Entrepreneurship, and co-founding the Global Social Benefit Incubator. Professor Bruno, who earned a Ph.D. at the Krannert School at Purdue University, has taught at Harvard University as a visiting research scholar, Sup de co, Rouen, France, and at the Naval Postgraduate School. In 1982, Professor Bruno was one of 13 recipients in the US of the Leavey Foundation Award. In the same year, he was honored with the Glenn Klimek Professorship at Santa Clara, which he held for 16 years. His many articles, research publications and book chapters have been published in a diverse set of business journals and periodicals. His book, *The Market Value Process: Bridging Customer and Shareholder Value*, was republished in German in 1998.

PATRICK GUERRA

Founder and Principal, Lions Peak LLC
Co-Founder, Global Social Benefit Incubator, Santa Clara University

Patrick Guerra has served in senior management information technology, manufacturing, distribution, product management and business development roles with Hewlett Packard, AMD, PSB, Ariba and SpinCircuit, where he was President and CEO. Pat's experience includes early stage business formation and the rapid scaling of technology-based ventures. He has served on numerous academic and early-stage company boards of advisors. Pat has also served as the Executive Director, Center for Innovation and Entrepreneurship at Santa Clara University, where he co-founded the Global Social Benefit Incubator. Pat holds a B.Sc. in Economics and a M.B.A. in Operations Management and Information Systems from Santa Clara University, where he is an adjunct member of the faculty in Entrepreneurship.

Pat has done groundbreaking work with Ashoka, the Skoll and Rockefeller Foundations, and Acumen in support of the scaling and sustainability of Social Enterprises. Most recently, he has developed the Social Enterprise Innovation Network — a *purpose driven network* designed to enhance the absorptive capacity for capital of global social entrepreneurial ventures. He continues his commercial entrepreneurial pursuits as an investor and consultant to early stage technology companies as a member of the Band of Angels.

CHARLY KLEISSNER, PH.D.

Co-Founder, KL Felicitas Foundation

Dr. Charly Kleissner is a philanthropic entrepreneur utilizing his high technology background in his venture philanthropy. He is co-founder of the KL Felicitas Foundation and the Social-Impact initiative, helping social entrepreneurs worldwide to accelerate and increase their social impact. Dr. Kleissner serves

Dr. Kleissner earned his M.S. and Ph.D. in Computer Science from the University of Technology, Vienna and has over twenty years of experience as a senior technology executive in Silicon Valley working for Ariba Inc., NeXT Software Inc., Digital Equipment Corp. and Hewlett-Packard Company. Dr. Kleissner is now focusing on breaking down the barrier between the for-profit sector and the not-for-profit sector by creating and supporting social enterprises as hybrid business structures, insisting that both vehicles can be effective for achieving social change.

HERSH SHEFRIN

Mario L. Belotti Professor of Finance,
Santa Clara University

Hersh Shefrin is the Mario L. Belotti Professor of Finance at Santa Clara University. His book *Beyond Greed and Fear* provides a comprehensive approach to behavioral finance, and in 2009 was recognized by J.P. Morgan Chase as one of the top ten books published since 2000. Among Professor Shefrin's other works are *A Behavioral Approach to Asset Pricing*, *Behavioral Corporate Finance* and *Ending the Management Illusion*. According to a 2003 article that appeared in the *American Economic Review*, he is one of the top 15 economic theorists to have influenced empirical work. His work is in the all-time top ten downloads from the Social Science Research Network. He received his Ph.D. from the London School of Economics in 1974. He holds an honorary doctorate from the University of Oulu, Finland, and is an honorary guest professor at Central-South University in Changsha, China. Professor Shefrin is frequently interviewed by the media on financial matters.