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Are We There Yet, Impact Investing?

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ABSTRACT:

Impact investing has been an evolving field for the past ten years. More and more institutional investors are looking to change their investment approaches to impact investing. Academics, institutions, and international organizations are creating reports and publishing research on the impact investing field, tracking its growing progress. Without any incidents thus far, impact investing is an industry that is about to burst. A retrospective and internal analysis of the field is needed in order to grow at a better and faster pace. This paper is attempting to fill a hole in the information about impact investing. It provides a comprehensive overview over what impact investing is and its historical background. Additionally, this project considers the future of impact investing and the challenges it faces while trying to provide solutions.

FOCUS QUESTIONS:

Impact investing was first coined in 2007 at a conference in The Rockefeller Foundation's Bellagio Center (*Innovative Finance*). The private sector started flocking to impact investing – helping fund companies in the developing world that would solve the Sustainable Development Goals (SDGs) set out by the United Nations – after realizing that it is at least a twelve trillion USD market with the potential to double or triple (*Better Business, Better World*, 2017). The field of impact investing has seen marked growth; the term impact investing has become mainstream as large financial institutions, and the wealthy started contemplating their investments (Shah, 2017). However, with time comes the need for retrospection. What is the real impact of impact investing? How do we evaluate it? How close has impact investing come to solving SDGs? What are the challenges that the professionals in impact investing are facing? What are potential solutions to the challenges? Does the impact investing work in the current economic model?

OBJECTIVES:

The objective of this research is to provide a retrospective and review on impact investing. It has been eleven years since the idea first drew attention; the bulk of growing has taken place in the past two year (K. Brown, personal communication, May 2, 2018). Tremendous growth means the need for standardization and further review on issues facing the field. This research paper will highlight the background history of impact investing, contextualize this investment approach in the sustainability trend, illuminate challenges, and propose potential solutions. The background and contextualization will mainly be discussed in the "Context and Literature Review" section while the challenges and solutions will be featured in the "Observation and Analysis of Focus Project" section.

JUSTIFICATION:

Why is this research necessary? The field of impact investing is wide and scattered. There are many organizations and task forces creating their own impact measurements without a centralized body organizing everything. Academics and organizations are publishing new research constantly. After years of progress and forward-looking, it is necessary for retrospection, self-reflection, and evaluation. With little research taking on that perspective, my research attempts to fill the void and help bring a deeper look into the history and challenges of impact investing. This research will help focus those in the field and provide newcomers and overview.

CONTEXT AND LITERATURE REVIEW:

As mentioned previously, impact investing was first coined in 2007 by the Rockefeller Foundation, who also created the Global Impact Investment Network (GIIN) in 2009 (Paetzold, 2017). However, impact investing was already practiced by Nordic countries, whom had taken a sustainable investment approach since the beginning of time (K. Brown, personal communication, May 2, 2018). They were originally limited to private investments or projects backed by equity or third-party financing (John Doe, personal communication, April 25, 2018). It was only in the past two years that impact investing has seen massive growth. Goldman Sachs bought Impact Capital; TPG established the Rise Fund, and Bain started Bain Capital (John Doe, personal communication, April 25, 2018). When asked what changed in the past two years, Ms. Brown cited the creation of the SDG framework as well as more sustainability-aware workers taking senior corporate positions. With the SDGs listed by the United Nations, investors can tangibly see how to make an impact, but needed a new implementation strategy. By creating the

SDGs, the United Nations encouraged impact investing to enter different asset classes (*Every investment has an impact*, 2017).

Before investigating into the impact investing field further, it is important to understand what it is and how it compares to other investment approaches. The definition of impact investing as well as ESG or social impact investing are not fully agreed on by the entirety of the community. However, the following definitions are perhaps the most inclusive and are categorized in the best way (Bridge Fund Management, 2017):

- Traditional – the traditional approach has limited or no focus on ESG factors underlying investment analysis and execution. It primarily focuses on competitive returns.
- Responsible investing (RI) – this investment approach integrates ESG risks into the analysis of all holdings, as a component of financial risk management. The behavior of holdings is heavily influence by shareholders, and this approach focuses on both competitive returns and ESG risk management.
- Socially responsible investing (SRI) – SRI screens negative and positive ESG risks to align a portfolio to specific values. Like RI, shareholders heavily influence the behavior of holdings. In addition to competitive returns and ESG risk management, SRI considers high impact solutions.
- Impact investment – impact investment is broken down into thematic and impact-first approaches.
    - Thematic – this impact investment approach focuses on investing in one or more issue areas where social or environmental need creates commercial growth opportunity for market-rate returns. Like SRI, this approach focuses

on competitive returns, ESG risk management, and high impact solutions. Unlike SRI, thematic impact investment concentrates on the product of a company rather than its business strategies.

  - Impact-first – the second type of impact investing focus on one or more issue areas where social or environmental need may require some financial trade-off. Unlike thematic impact investing and the previous investment approaches, impact-first investing does not focus on competitive returns, but mainly on ESG risk management and high impact solutions.

- Venture philanthropy – venture philanthropy funds social enterprise in a variety of asset classes and with a range of return possibilities. It is very common for investors to be involved in the enterprise. This approach focuses purely on creating high impact solutions.

Based on these definitions, we see that impact investing is, in fact, on a spectrum of sustainability investment approaches. Impact investing straddles the competitive returns and impact-first mindset of sustainability investment strategies. The core characteristics of impact investing are listed below (Paetzold, 2017):

1. Intentionality – investees, through core activities in business, specifically try to achieve a position on social or environmental impact. Examples include healthcare services for underserved populations, educational technology, or social housing.
2. Measurability – investments are committed to and have the ability to measure and report the social and environmental outcomes of investees' business activities. These can be done through a systematic setting of social and environmental goals as well as performance metrics, monitoring, and reporting processes.

3. Range of return expectation, regions, and asset classes – investments must maintain returns and be diversified across world markets and asset classes.
4. Additionality of investment capital – impact investments must optimize the catalytic effect of deployed capital. The capital is additional and not in over-subscribed funds or mainstream projects. Examples included anchor investments into first-time funds, social impact bonds, and investments in underserved technology, populations, or markets.

The main demand for impact investing comes from impact-seeking purchasers and impact-driven organizations; these are the people or institutions that are driving the movement towards impact investing as a new investment strategy. Purchasers include government, foundations, socially-minded consumers, and socially-minded corporate purchases. Organizations include charities, grant-funded organizations with trading activities, social enterprises, profit with purpose businesses, and businesses that set significant outcomes objectives. Capital supply comes from channels and sources of impact capital. Channels include social banks, community development finance institutions, impact investment fund manager, impact investment intermediaries, and crowd-funding platform. On the other hand, sources of impact capital come from the government, social investment wholesalers, charitable trusts and foundations, local funds, institutional investors, institutional banks, corporate, high-net worth individuals and mass retail. The demand and supply meet in the different forms of asset classes: secured loans, unsecured loans, charity bonds, social impact bonds, quasi equity, equity, and grants (Social Impact Investment Taskforce, 2017).

For each impact investment, investors must maintain due diligence by measuring impact. Many investors use the Impact Reporting and Investment Standards (IRIS) to evaluate the impact of their investment. IRIS is “a catalog of generally accept performance metrics”; it’s not a methodology but rather a database of metrics investors can choose from to quantify impact (Murphy & Schiff, 2015). IRIS uses metrics from 18 different industry specific frameworks like Community Investing, Healthy Communities, Impact Employment, and Small and Growing Business (*Aligned Metric Sets*). Based on the latest report, 4989 organization have used IRIS (Murphy & Schiff, 2015).

Today, impact investing is a $114 billion market (Jane Doe, personal communication, April 13, 2018).

METHODS:

To investigate the background of the impact investing and contextualize its position in the sustainability trend, I read many reports by different organizations that outline their history with impact investing and their outlook. Reports include qualitative interviews with industry professionals and general background on impact investing. They also include quantitative measurements that assess the size of impact investing and categorize the type of investments and organizations. By reading reports ranging from international organizations to private banks, I was able to piece together a more unbiased view of the investment space. Reports from the Social Impact Investment Taskforce focus on the policy aspects of impact investing and propose policy solutions while reports from IRIS provided an overview of invested organizations. Moreover, I was able to understand the mindset of both traditional investors and impact investors as well as the view of governing bodies.

To further my understanding of the impact investing field, I also interviewed three distinct individuals working in the investment field. The first is an active manager of an impact investing field at LombardOdier, Jane Doe[1]. My second interviewee is the head of impact investment and sustainable investments at the World Economic Forum, Katherine Brown. My final interviewee is an asset manager who is managing a fund that has not implemented the impact investing approach, John Doe[2]. The three interviews were structured semi-formally. Before I started the interview process, I created a list of questions that centered around the interviewee's background and impact investing. The following are some of the questions I asked in each of the interviews:

1. Tell me about your background.
2. What does your day-to-day look like?
3. How did you enter the field of impact investing?
4. What are challenges that face impact investing and what are some potential solutions?
5. Are you optimistic about the future of impact investing?

Based on the interviewee's response, I would ask other questions that I had not previously written down. The three interviews provided invaluable insight into the background and trends of the impact investing field.

Jane Doe was able to provide insight on how impact investors manage their funds on a daily basis and the due diligence that was required. I meet her through a course speaker who also works at LombardOdier. The speaker was kind enough to recommend me Ms. Doe. I emailed her – explaining that I am a student studying abroad in Geneva and currently researching impact investing – and dropped the speaker's name as a reference. She was kind enough to open time in

[1] The name of the expert is known by the author.
[2] The name of the expert is known by the author.

her schedule to speak to me. I ensured that email communication remained professional and that any requests from interviewees are followed.

Katherine Brown expanded my perspective on impact investing to include organizations working to bring together investors and standardize the field. I was referred to her by Ms. Doe and reached out in a similar manner. Again, I received an immediate response and was quite fortunate to be able to meet with her. I continued to maintain professional communication.

Lastly, I meet with John Doe, from whom I received the point-of-view of an apprehensive investor. I was referred to him by a classmate and reached in a similar manner as the previous two interviewees. He was extremely busy so I became more flexible when meeting him, sacrificing some class time so I could conduct the interview and respect his schedule. Additionally, I also respected his wishes to remain anonymous and keep his workplace undisclosed.

I spent mostly nights and weekends working on the project focus. In total, I spent an hour a night reading reports or watching videos on impact investing. I spent 15 hours writing the paper and organization everything together. I also recorded my interviews and daily work in the journal in the appendix every day.

ETHICS:

Ethics must be considered in both my research methods and project focus. To begin with, when involving human subjects in research, it is important to maintain ethical standards. With the help of SIT, I filled out a Human Subjects Review application that ensures I would practice ethical standards when working with human subjects. These standards include:

1. Human subjects will not be exposed to unreasonable harm.
2. Human subjects have a right to their privacy.

3. Human subjects can choose to remain anonymous or leave information undisclosed.

I maintained these ethical standards when searching for interviewees and during the interview process. No interviewees were harmed in this process. Before starting each interview, I briefed each interviewee over their rights to privacy. They could remain anonymous and request pieces of information to remain private. Additionally, they were aware that I was taking notes over their answers and will be quoting them in a research paper that is only published to SIT employees.

While the project focus does not directly deal with the ethics of banking, impact investing is a more ethical investment strategy than traditional approaches. Analyzing impact investing's progress and flaws can enable it to become a more dynamic and robust investment approach, allowing more investors to join the field and participate in ethical investment.

OBSERVATION AND ANALYSIS OF INTERNSHIP ORGANIZATION:

I interned at Sofies Group, a consulting firm that specializes in sustainability issues. Sofies Group operates in six main activity areas: alternative energy, industrial ecology and circular economy, land resource development, sustainability, value chains, and waste and resources. They have clients in four different categories: public entities, enterprises, international organizations and development agencies, and research and training institutions (*Service*). Sofies Group has also worked on more than forty distinct projects, ranging from cleaner production in the rice sector in Vietnam to creating an e-waste recycling shop in Morocco (*Projects*). Sofies Group's mission is to provide sustainable solutions all over the world (Resource Efficiency and Cleaner Production: Case Study, 2018). Currently, Sofies Group has main offices in Geneva, Zurich, Paris, the UK, and Bangalore, but works in many other countries.

Sofies' strength lies in their technical expertise. Out of the thirty-one consultants, twenty-five have background in the sciences (*About Us*). With so many Masters and PhDs, Sofies can provide strong technical expertise on creating sustainable and profitable solutions. Their greatest weakness lies in the lack of funding. According to Anne Verniquet, a consultant at Sofies, their biggest challenge is finding funding to implement the solutions. Many of the companies they work with don't have access to large financial institutions and rely on Sofies to provide funding (Resource Efficiency and Cleaner Production: Case Study, 2018). Therefore, their greatest opportunity is in finding a financial institution that would be willing to invest in their projects. If their company becomes part of an impact investor's portfolio, they will be able to take on more projects and grow their company.

However, Sofies faces threats from the major four consulting firms as well as other boutique firms. Companies, like Green Consultants, BSR, and SustainAbility, also work to provide sustainable practices to their clients. Fortunately for Sofies, these firms primarily work with large corporations or municipalities in developed countries and in different sectors. The majority of Sofies' work in currently in agriculture while these companies work in the industrials, food, entertainment, and financial services industries (*Clients & Projects, Our Industry Focus, Green Consultant Clients*). While these companies focus on sustainability in companies at the end of the value chain, Sofies' mission is to provide sustainable changes to companies in the developing world and in the middle of the value chain. Sofies is unique in their client pool, team expertise, and their project goals.

As an intern, I was tasked with finding new financing sources and challenging Sofies' financing tool. After reading previous interns' reports on impact investing as a potential financing source, I realized that Sofies' encapsulates one of the largest problems facing impact investors: project size. For Sofies, most projects capital requirements are between those of microfinancing and traditional investments. For large institutional investors, they are looking for invest a certain percent of their capital; often that can be in the billions or trillions (K. Brown, personal communication, May 2, 2018). This means that institutional investors want to invest more money than the project allows. Sofies Group and their issues with financing was a real-life example of an issue that impact investors face. During my time at Sofies Group, I started investigating the possibility of green bonds as a potential financing source. From my research, I found that it is a very real possibility for Sofies, and that they also have the potential to become a green bond validator.

In addition to research green bonds, I also examined the financing tool and determined that its current process is inefficient. Sofies' employees who use the tool must enter their project details twice. First, they enter in their information on the 'Project Data' Excel sheet. Then, they must sort the database of financing sources to fit their project details. My goal was to create an Excel function that would automatically sort the list of financing sources after the employee enters the project details.

While this project does not directly relate to my project focus, I learned lessons are applicable through my communications with the financing sources listed on the financing tool. After reaching out to commercial banks and investors and reading previous reports, I realized how difficult it is to build trust and persuade an individual to adopt a new strategy. Much like impact investing, it was difficult to convince financing sources that sustainability can yield positive returns.

Sofies is also working on a project that will measure the financial impact of natural capital. While I was not privy to the details of this project, the knowledge that it exists helps me add another data point to my list and allow me to further spread my view of institutions researching the ways to quantify impact.

OBSERVATION AND ANALYSIS OF FOCUS PROJECT:

Based on the research and interviews, I realized that there are several problems in the impact investing field, from having too much capital to a lack of standardization. After discussing with all my interviewers, the biggest problem seems to be too much capital for the size of investments. Most impact investments are in small companies operating in emerging markets, meaning their investment size ranges from a couple thousand to low millions. Traditional investors are required to invest billions to trillions. There is simply too much demand for the supply. A potential solution could be to focus impact investing into specific asset classes or change the structure of investments. Equity-based impact investments are facing the largest demand and supply issues. More structured debt-based investments can alleviate some of the problems. Debt-based investments are easier to pool and collaterize. By pulling multiple companies into one debt structured investment fund, investors will have the ability to invest large amounts into firms providing social or environmental impacts. Currently, LombardOdier is investigating the possibility of creating a more structured investing platform (Jane Doe, personal communication, April 13, 2018).

The next largest problem is a lack of standardization. Currently, 75% of those measuring impact are using proprietary metrics or frameworks, 65% qualitative information, and 57% IRIS-aligned metrics (companies tend to use many metrics) (Mudaliar, Schiff, Bass, & Dithrich, 2017). There are simply too many organization that are creating measurement standards and no coordination among them. A lack of standardization makes it difficult for investors to investors to compare the impact of companies across the board. However, the impact investing community is aware of the issue and making strides towards standardization. The World Economic Forum (WEF), along with the GIIN, is creating a tool kit to reduce fragmentation in impact measurement approaches (K. Brown, personal communication, May 2, 2018). The WEF is creating a tool kit, instead of standardizing measurement standards, because it is aware that different industries have different ways of measuring impact. For example, impact investments that are developing employment will look at job growth while investments that are building better sanitation systems will look at diseased populations. A tool kit is more effective way of standardizing measurements without forcing all impact investments to use measurements that might not be applicable.

The final problem is the small investor interest in impact investing. Despite the explosive growth the past two years, only a small percent of fund managers is exploring impact investing. It was only recently that large financial institutions began to develop their sustainability investment strategies. For older investors, it can be difficult to separate the notion of low returns with sustainability (John Doe, personal communication, April 25, 2018). After talking to several industry professionals, the best solution is to show investors a demonstrative relationship between financial return and impact investing. Impact investing does, in fact, produce financial returns that are on par to, or better than, regular investments. Once investors are re-assured that this new investment strategy does not cost them returns, they are willing to adopt the new investment approach (John Doe, personal communication, April 25, 2018; K. Brown, personal communication, May 2, 2018).

The general feeling toward impact investing is positive. Institutional investors are starting to shift their attentions to more sustainable investment strategies. As the environmentally-friendly millennials graduate into the work force, there will be a larger push into the impact investment field. However, investors should expect a crash. Currently, the growth in impact investing is mirroring a bubble. The general sentiment is that a crash is imminent, but investors will learn from the cause and build better foundations for impact investing. The future is looking bright as more and more interest in the field is building. The change is not coming too soon as our planet continues to face challenges that could threaten our existence.

CONCLUSIONS:

Impact investing has been a used investment approach, but was initially defined by the Rockefeller Foundation in 2007. It faced slow growth until two years ago, when the UN created the SDGs, making it easier to evaluate impact needs around the world and expand impact investing to new asset classes. The field currently faces three main problems: demand-supply imbalance, lack of standardization, and fear from investors. Moving forward, impact investors will need to be aware of these problems in order to maintain growth and progress. They should also keep in mind that Nordic countries have adopted this investment approach before the term was coined in 2007. By studying their financial portfolios and returns, investors can learn how to better manage their investments.

Further research is needed to truly develop solutions to these problems. While different organizations are working to resolve these issues, more centralized research is needed to establish a common understanding across the industry. Additionally, this paper failed to attack the issue of evaluating impact. This subject is too large to be grouped with other problems facing impact investing and requires its own attention. Moreover, there are too many methods in the field that are measuring impact. ESG and GIIRS are both strategies; Sofies Group is developing a model that will evaluate the natural capital impact of a company.

In my internship, I also deepened my understanding of the impact investing field by seeing a real example of one of the problems listed in this paper. I also expanded my skills in Excel and communications.

APPENDIX

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INTERNSHIP JOURNAL ENTRIES

9 April 2018
This was the first day of my internship. We meet the Sofies team and sat in on their team meeting. We interacted with them and other workers at the co-working space's one-year celebration. We re-organized the database that contains the list of possible project financiers to make it easier to read and find information.

10-11 April 2018
Desi and I meet today to compile all the financing sources into one Excel sheet. We also included information about their investing size, financing countries, and type of projects they finance. Additionally, we included information from previous interns on if the commercial banks are willing to work with Sofies and a record of their interaction.

12 April 2018
I spent the day evaluating the financing tool and trying to figure out the best way to configure the information in the database. I discovered that the tool requires the user to input their project details twice; that seemed like an inefficiency, and I started investigating functions that would link the database information with the project details.

13 April 2018
Today I meet with my first interviewee. She talked about how LombardOdier approaches their impact investing portfolio, and I realized that impact investing is an investment approach that is applicable across asset classes. We had a great conversation, and I was able to further deepen my understanding of the field from the perspective of an investor.

16 April 2018
Desi and I went to the office today and updated Anne. She told us she wanted us to look into different funding possibilities. Desi looked into crowdfunding and infrastructure funds while I investigated the green bonds sphere. I found lots of resources, the main one from EY. I reached out to EY for further information but did not receive a reply. This could be a point of further exploration by interns.

17 April 2018
I continued my foray into green bonds. I think that green bonds are a feasible financing method for Sofies' but the process seems to be long. Additionally, I haven't really figured out if companies that Sofies' works with can issue bonds and what that process looks like in different countries.

18 April 2018
Desi and I meet to catch each other up on our investigations. I helped Desi with finding more infrastructure funds, and she helped me look into bond markets abroad. Infrastructure funds are a very interesting. I realized that there are multiple different asset classes in infrastructure funds. Equity funds are the most interesting because people are specifically investing in companies that support the infrastructure of an emerging market.

19 April 2018
I started to brainstorm ways to automatically create a list of financing sources based on the project details input in the financing tool, an Excel spreadsheet. My knowledge of Excel is only at an intermediate level, and this task proved more difficult than expected. I can map out the steps to achieve the final result, but am not sure how to translate that into Excel functions. I started reading articles over Excel arrays and IndexMatch functions.

23 April 2018
I wasn't feeling well today and did not meet with Anne and Desi.

24 April 2018
I'm still working out the kinks of the Excel functions. At this point, I think it might be easier to use a SQL server. The data is not organized in a way that Excel functions can work well with. A lot of cells list multiple countries or financing types. Excel has a difficult time parsing while SQL is easier. However, I'm determined to get a prototype worked out. Perhaps the next intern can transfer to data to another database software.

25 April 2018
I interviewed another person. He is currently an asset manager who has not started exploring the field of impact investing. I learned more about the reservations institutional investors have about sustainability investing. I pitched him my beliefs, and I think he's starting to come around. He provided great insight as to why he is not using an impact investment approach. It is important to remember that fund managers have to answer to those giving money to the funds and are not privy to make their own decisions.

26 April 2018
I finally got the Excel function to work! However, it only returns financing sources that match the country listed. Additionally, it won't list financing sources that have multiple countries listed. I'm looking into also providing financing sources based on the project industry but realized that we didn't include that information in the database. I'm re-researching at all the financing sources to see if they prefer any industries.

30 April 2018
We presented our experience and work on the Sofies' financing tool to the Sofies' team. They seemed to be interested and pleased with our results. Anne was unable to make it to the meeting, so we talked to her virtually. We'll spend the next couple days wrapping up our work and writing final reports.

1 May 2018
I spent today working on writing final reports over the green bonds and investigating further. I've listed potential people to contact and my analysis of Sofies' role in the green bonds process.

2 May 2018
I interviewed my final interviewee. She is working as the Head of Impact Investing at the World Economic Forum, and provided some crucial insight on how she views the future of impact investing. I also talked to her about her career path. She started out in the service and events

planning industry, then completed a Masters at LSE and received the World Economic Forum Fellowship. She showed me that you can always end up working on what you want to, as long as you put in the time and effort towards your passion. Additionally, she provided an interesting insight on how international organizations are working to unify the disjointed field of impact investing.

3 May 2018
We meet with Symbiotics today. It was incredibly enlightening to hear about their growth and problems. I can't go in details here, but they've been expanding in Asia. Apparently, Sri Lanka and Myanmar have a lot of potential. They've been trying to provide more loans to SMEs, but have failed in their endeavor. Investors and board members are not too happy, so they've been hesitant to try anything new. I think it's important to remember that very often, institutions cannot spend money all willy-nilly. They answer to a board and the individuals who've invested their hard-earn money into their portfolio. This meeting provided insight on the tension between impact investing/microfinancing fund managers and the individuals who've invested.