GSG
Driving real impact

The Impact Principle

Widening participation and deepening practice for impact investment at scale

Working Group Paper Extract:
FIELD DEFINITION

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About The Working Groups

Members of the Working Group on Widening Participation and Deepening Practice for Impact Investment

WORKING GROUP MEMBERS	
Abhilash Mudaliar	Director, Research, The Global Impact Investment Network
Amit Bhatia (ex-officio)	CEO, Global Steering Group for Impact Investment
Ben Thornley	Managing Partner, Tideline
Clara Barby	Partner, Bridges Impact+
David Korslund	Senior Advisor to the Executive Director, The Global Alliance for Banking on Values
Erica Barbosa-Vargas	Director of Solutions Finance and Impact Investment, JW McConnell Family Foundation
Fiona Reynolds	CEO, UN supported Principles for Responsible Investment
Francesca Spoerry (ex-officio)	Program Manager, Global Steering Group for Impact Investment
Harvey Koh	Managing Director, Inclusive Markets, FSG
Julie Segal (research)	Impact Investment Analyst, JW McConnell Family Foundation
Karim Harji	Senior Fellow, JW McConnell Family Foundation; Programme Director, Oxford Impact Measurement Programme, Said Business School, University of Oxford
Krisztina Tora	Director Market Development, Global Steering Group for Impact Investment
Maha Keramane	Social Business Manager, BNP Paribas
Maria Tinelli	Managing Director, Acrux Partners
Rachel An (research)	Intern at Brightlight Impact Advisory
Rosemary Addis (Chair)	Executive Director, Impact Strategist; Chair Australian Advisory Board on Impact Investing and Impact Investing Australia
Sally McCutchan (ex-officio)	Executive Director & CEO, Impact Investing Australia
Shanthakumar Bannirchelvam (Working Group Coordinator)	Managing Director, Global Strategy Partners

Other GSG Working Group Reports

WORKING GROUP NAME	PILLAR REPRESENTED	TOPICS
Building Impact Investment Wholesalers	**Supply of Capital**	It details the what, why and how of building impact wholesalers
Catalysing an Impact Investment Ecosystem: A Policymaker's Toolkit	**Policy & Advocacy**	It focuses on the role of government in the impact investment ecosystem and highlights how policy making can be catalytic
Enabling ventures to leverage technology for impact	**Demand of Capital**	It analyses the different enabling elements across the lifecycle of impact-tech, and focuses on recommendations to improve the global tech-for-good ecosystem
Investing for a better world	**Supply of Capital**	It focuses on recommendations to strengthen the financial services value chain to meet the sustainable development goals
Widening & Deepening the Market for Impact	**Market Builders**	It outlines the why and what of impact investing and presents a theory of change for widening participation and deepening practice with practical guidance on actors and levers

This report is a chapter taken from the GSG Working Group report: Widening and Deepening the impact Market.

In this paper, we discuss how to widen and deepen the field of impact investment to ensure that a wider variety of actors are represented and the focus on impact remains transparent and measured.

The entire paper can be found on the GSG website:
https://gsgii.org/wp-content/uploads/2018/11/GSG-Paper-2018-WideningDeepening-the-Market-Nov.pdf

Companion Papers to this can be found on the GSG website.

About this note

This note builds on the experience of practitioners in impact investing and in other fields of practice to propose a field definition for impact investment. The focus of this extract is defining the landscape of impact investment.

The material was developed with The Impact Management Project, a forum for building global consensus on how to measure, manage and report impact www.impactmanagementproject.com

About Impact Investment and The Impact Economy

To navigate the complexity of achieving a future where no one lives in poverty and the planet thrives, we need a simple unifying principle: that it is the role of all actors in society to examine how their actions effect the people and the planet.

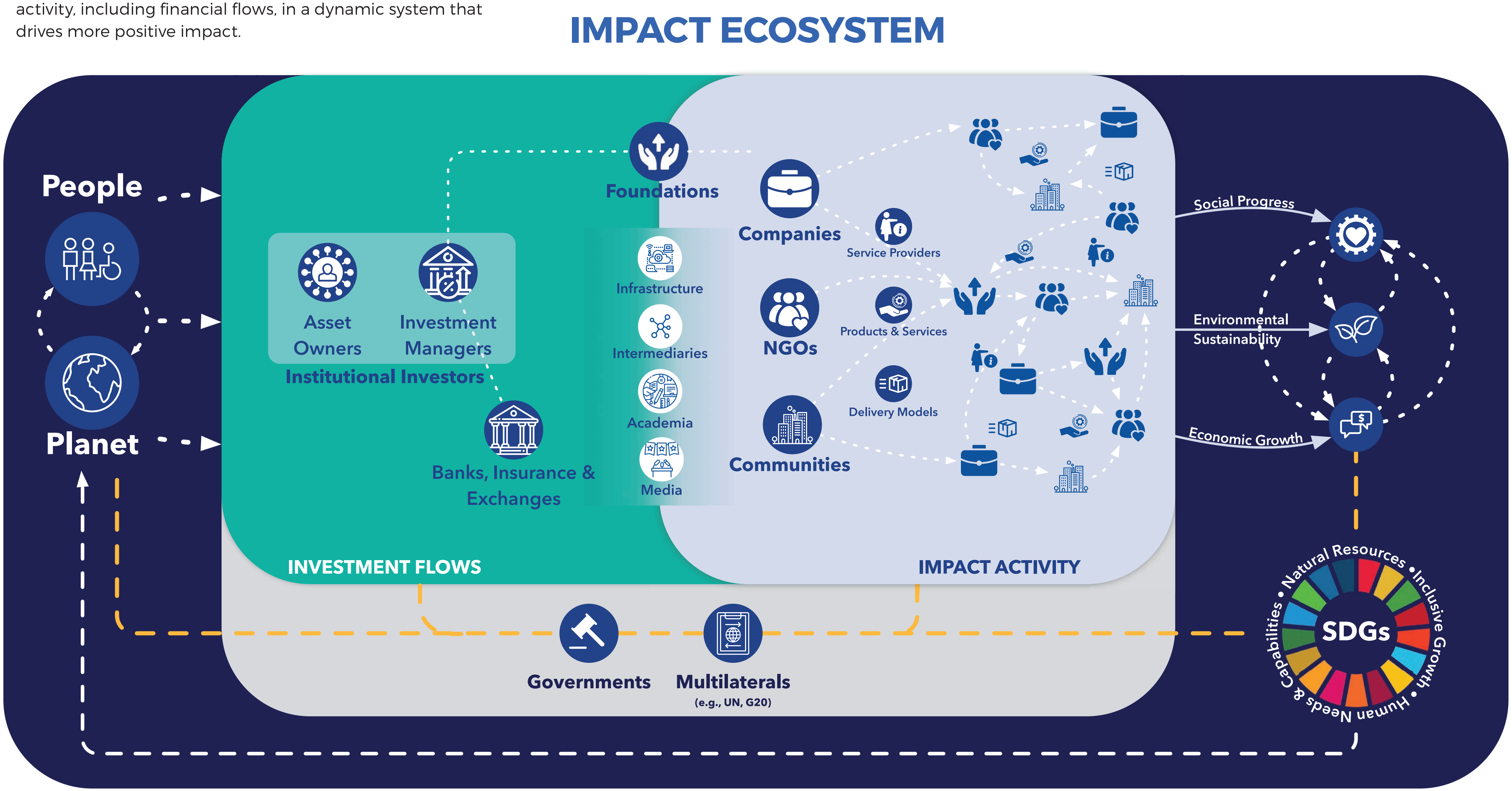
Impact investment optimizes risk, return and impact to benefit people and the planet, by setting specific social and environmental objectives alongside financial ones, and measuring their achievement. Impact management is a critical practice to reach this potential.

As more people and organisations get involved and become more successful in impact investing, there is a cumulative effect. A vibrant and growing impact economy can develop where businesses, investment and activity deliver tangible improvements in outcomes for people and the planet. In the impact economy, businesses use their capabilities to optimise both their positive impact on the world and their financial return. Investors use their resources to optimise business impact, adding and creating value beyond what would otherwise be achieved.
The momentum of more positive impact being generated enlivens the possibility of an inspiring future.

FIGURE 1:

High-level view of an impact ecosystem

This figure presents a simplified visual of the actors and activity, including financial flows, in a dynamic system that drives more positive impact.



Source: Design by Murphy, R in collaboration with Addis, R and Barbosa-Vargas, E for the JW McConnell Family Foundation adapted from UN Global Compact and KPMG, *SDG Industry Matrix: Financial Services*, 2015 and UN Global Compact, UNCTAD, UNEPFI, *PRI Private Sector Investment and Sustainable Development*, 2015

Directing Investment to Impact

Capital is a necessary ingredient for impact at scale; the flow of capital provides powerful incentives for what is achieved and valued. Many positive initiatives do not get started and cannot grow without resources. Without attention to impact, finance continues to flow to activity that creates negative effects for people and the planet.

Impact investment, designed to achieve positive impact and measure the results, has impact hardwired into its design and management. This has a powerful role to play in meeting the SDGs and will play an integral role in developing the impact ecosystem. The focus on impact can, in turn, put focus on what people need and opportunities for solutions.

Navigating impact investment

To meet the promise of impact investment, impact must be clearly in frame. Just as greater appreciation that risk could have on financial performance of investments in the late 20th century led to risk becoming a more explicit and integrated vector in decision making, the next evolution is to integrate impact as an explicit factor in investment decisions.

Some entering impact investment are motivated by growing pressures such as food and water security. Others are motivated by the potential to achieve outcomes that benefit more people equitably and sustainably. Yet others see potential to develop new products and services or open new markets that meet people's need for safe water and sanitation, education, clean and reliable energy, transport and housing.

Impact investing is an innovation story in its own right. It is also an enabler of innovations, providing the capital to finance new models, infrastructure and entrepreneurial activity focused on addressing issues affecting our society.

Just as risk-adjusted return ultimately links to the underlying assets and enterprises into which investment is being directed, so too impact relates to the effects, positive and negative, that underlying assets and enterprises have on people and the planet.

Like expectations of risk and return, expectations for impact need to be informed by data and experience. Recent collaborative efforts have established the first broad-based consensus on how impact is understood and managed[7].

These and other developments and insights enable a new paradigm of risk, return and impact.

Figure 1 provides a conceptual framework of how the intentions and capabilities of investors map to the impact of different investment products. Figure 2 illustrates potential for mobilising additional capital for solutions by 2030.

The matrix below helps investors understand and describe the impact performance for an existing investment, or portfolio of investments and the impact goals of new products. Much like financial asset classes are a helpful heuristic for quickly conveying whether the characteristics of an investment opportunity match an investor's financial intentions, the boxes on this matrix are an equivalent shorthand for conveying whether the impact characteristics of an investment opportunity match an investor's intentions for achieving impact.

An investment's impact is a function of:

- ▲ The impact of the underlying asset(s)/ enterprise(s)[8] that the investment supports (on x-axis);
- ▲ The contribution that the investor makes in enabling the enterprise(s) to achieve that impact; (on y-axis).

An impact economy necessitates that measurement of social and environmental impact is integrated in all economic activity; and central to government policy, business operations, investor behaviour, and consumer consumption.

How far different enterprises - and their investors - go depends on their intentions, constraints and capabilities:

A. Enterprises can **act to avoid harm** for their stakeholders. For example, reducing CO_2 emissions, or reducing child labour in supply chains. This includes environmental, social and governance risk management.

B. Enterprises can also actively **benefit stakeholders**. For example, selling products that support good health or educational outcomes. This includes pursuing environmental, social and governance opportunities.

C. Enterprises can also use their capabilities to **contribute to solutions** to pressing social or environmental problems. For example, providing health or educational services in communities that currently have no access to them, or providing financial services to people without credit or bank services.

Impact practice builds on existing foundations in business and investment as reflected in the incorporation of ESG and socially responsible investment as part of the toolbox to assess what will avoid harm, benefit stakeholders or contribute to solutions. Impact enterprises use their capabilities, not just to avoid harm and benefit their stakeholders, but also to contribute actively to solutions, thereby optimising both their positive impact on the world and their financial viability.[9] Impact investors bring their own resources to bear to optimise enterprises' impact, within the context of their constraints and capabilities.

Applying impact strategies requires investors to consider and communicate how they add value to an enterprise's positive impact above and beyond what the capital markets are already enabling. The objective is to make progress on societal issues that will otherwise go unaddressed. Impact investments channel more resources to enterprises to optimise their impact and this is most effective when investors utilise the full suite of strategies.

In an impact economy, enterprises use their capabilities to optimise both their positive impact on the world and their financial performance. Likewise impact investors bring their own resources to bear in optimising enterprises' impact, within the context of their constraints and capabilities, above and beyond what the capital markets enable. Investors use various strategies to contribute to impact, often in combination:

- Signal that impact matters, to favour certain investments such that, if all investors did the same, it would lead to a pricing-in of effects on people and planet by the capital markets. Often referred to as values alignment, this strategy is an important baseline for an impact economy but has a much lower probability of making near-term progress on societal issues when compared to other forms of contribution.
- Engage actively, by using expertise, networks and influence to improve the environmental and societal performance of businesses.
- Grow new or undersupplied capital markets, by anchoring or participating in new or previously overlooked opportunities. The investor seeks a commercial return even though the transactions may be more complex, less liquid or involve some perceived risk disproportionate to return.
- Provide flexible capital, recognising that certain types of enterprises will require capital on lower risk-adjusted financial terms to generate certain kinds of impact, including by accepting more risk, investing over longer periods, in smaller units or agreeing terms not usually offered by commercial investors.

[8] The term *enterprise* is used to cover a wide range of delivery models, including multinational corporations, small to medium sized enterprises, infrastructure projects, social enterprises and charities and includes intermediaries and investment managers

[9] Some investment opportunities in solutions to pressing societal issues can be invested in to achieve market-rate, or even market-beating returns; others that require an intentional balancing of financial viability and impact performance.

FIGURE 2:

Mapping the ABC of impact to the way investors can contribute suggests opportunities for wider and deeper impact investment

The matrix helps investors to understand and describe the impact performance (or, if a new product, the impact goals) of an investment, or portfolio of investments. Much like financial asset classes are a helpful heuristic for quickly conveying whether the characteristics of an investment opportunity match an investor's financial intentions, the boxes on this matrix are an equivalent shorthand for conveying whether the impact characteristics of an investment opportunity match an investor's impact intentions.

Impact investors therefore typically spend their energy in the righthand column of Figure 1 below, supporting and scaling enterprises that contribute to solutions and go beyond signalling. Such investors often find it beneficial to accumulate deep knowledge and understanding of the social or environmental problem they are looking to solve and the system within which it exists, and to build capacity within investee organisations. By doing so, impact investors play a catalytic role in the evolution of the impact economy. In the near-term, since impact management practice is nascent, investors can also contribute to positive impact in by enabling large companies to avoid significant harm – for example, providing capital for environmental retro-fitting of carbon intensive factories, or using shareholder activism to address poverty in a multinational corporation's supply-chain.

IMPACT CLASSES — **IMPACT OF UNDERLYING ASSETS/ ENTERPRISES**

INVESTOR'S CONTRIBUTION

		A	B	C
		Act to avoid harm Prevent or reduce significant effects on important negative outcomes for people and the planet	**Benefit stakeholders** Have various effects on important positive outcomes for people and the planet	**Contribute to solutions** Have a significant effect on specific important positive outcome(s) for underserved people or the planet
1	**Signal that impact matters** + Engage actively + Grow new/undersupplied capital markets + Provide flexible capital	E.g. Ethical bond fund	E.g. Positively-screened/ best-in-class ESG fund	E.g. Sovereign-backed bonds (secondary market) funding vaccine delivery to understand people or renewable energy projects
2	**Signal that impact matters** **+ Engage actively** + Grow new/undersupplied capital markets + Provide flexible capital	E.g. Shareholder activist fund	E.g. Positively-screened/ best-in-class ESG fund using deep shareholder engagement to improve performance	E.g. Public or private equity fund selecting and engaging with businesses that have a significant effect on education and health for underserved people
3	**Signal that impact matters** + Engage actively **+ Grow new/undersupplied capital markets** + Provide flexible capital	E.g. Anchor investment in a negatively-screened real estate fund in a frontier market	E.g. Positively-screened infrastructure fund in a frontier market	E.g. Bond fund anchoring primary issuances by businesses that have a significant effect on environmental sustainability, access to clean water and sanitation
4	**Signal that impact matters** **+ Engage actively** **+ Grow new/undersupplied capital markets** + Provide flexible capital	*Investment archetype not widely observed*	*Investment archetype not widely observed*	E.g. Private equity fund making anchor investments in businesses that have a significant effect on income and employment for underserved people
5	**Signal that impact matters** + Engage actively **+ Grow new/undersupplied capital markets** **+ Provide flexible capital**	*Investment archetype not widely observed*	*Investment archetype not widely observed*	E.g. Below-market charity bonds, or an unsecured debt fund focused on businesses that have a significant effect on employment for underserved people
6	**Signal that impact matters** **+ Engage actively** **+ Grow new/undersupplied capital markets** **+ Provide flexible capital**	*Investment archetype not widely observed*	*Investment archetype not widely observed*	E.g. Patient VC fund providing anchor investment and active engagement to businesses that have a significant effect on energy access for underserved people

Source: The Impact Management Project, 2018

Mapping the potential for impact and investment

There is significant potential to direct more capital to achieve more and deeper impact. Ten years after the initiative sponsored by the Rockefeller Foundation placed concerted focus on market development there has been significant progress[10] – and a lot of territory that remains uncharted.

The 2018 GIIN Impact Investor Survey reports that 226 respondents collectively hold US$228.1 billion in impact investment assets under management.[11] Research collated from sustainable investment surveys indicates assets under management for sustainable investment have reached approximately US$23 trillion, and integration of sustainable investment overtook negative screening from 2014.[12]

While market size is important, what is more important is the direction of travel. There has been steady and accelerating growth in both socially responsible and impact investing and there is more coherent and growing practice.

The building momentum suggests that the ambition to mobilise an additional 5% of global assets under management each year (approximately US$6 trillion) more purposefully toward achieving the SDGs is and should be, a realistic goal. Figure 2 illustrates potential for mobilising additional capital for solutions by 2030.

In addition to growing the capital flow to more positive impact, achieving the promise of impact investment will mean driving, growing and disseminating solutions that are responsive to people's needs and can sustain the planet.

At the heart of delivering impact is what people want and need. Opportunities for impact and investment arise from greater understanding of the needs and aspirations for financial services, education and healthcare, quality options for old age, quality stable jobs and choices that are better for the environment.

To ensure investments connect with what people need, there is work to do along the value chain. More than 80% of institutional investors have indicated they plan to engage investee companies on the SDGs.[13] Corporate leaders have estimated achieving the SDGs opens up approximately US$12 trillion in new market opportunities and cost reductions across four key segments: food and agriculture, cities, energy and materials, and health and well-being.[14]

The 2030 Agenda provides a commonly agreed set of priority positive outcomes with indicators[15]. The SDGs have gained currency, including with business and institutional investors, in an environment primed to pay greater attention to systemic risks and the way in which business and investment can better serve the needs of more people.[16]

10 For example, the GIIN, *Roadmap for the Future of Impact Investing: Reshaping Financial Markets*, 2018

11 The GIIN, *Annual Impact Investor Survey*, 2018

12 Morgan Stanley, *Sustainable Signals*, 2018 and C-Change analysis for these GSG papers; Convergence for the Blended Finance Taskforce, *Who is the Private Sector?*, 2018 see Figure 9.

13 ShareAction March 2016 cited in UN supported Principles for Responsible Investment, *A Blueprint for Responsible Investment*, 2017

14 Business & Sustainable Development Commission, *Better Business: Better World*, 2017

15 Global Goals Dashboard with Major Indicators adapted from 2018 Progress report

16 See for example, PGGM and APG work to develop an SDG taxonomy https://gateway.sdgcharter.nl/SDI, UN supported Principles for Responsible Investment, *Investment case for SDG alignment 2017*; Burckart, W, Lydenberg, S, Ziegler, J, *Measuring Effectiveness: Roadmap to Assessing System Level and SDG Investing*, 2018

FIGURE 3:

Mapping investment product to the impact investor matrix illustrates the potential for mobilising additional capital for solutions by 2030

As we set our sight on a full-fledged global impact economy by 2030, we can expect significant growth in impact investments, which enable enterprises to contribute to solutions, optimising their risk, return and impact. Given the rise of impact entrepreneurship and the encouraging response of enterprises and investors to the SDGs, it is becoming realistic to think that every asset class can include a percentage of impact investments which, taken together, would unlock capital at scale to address the world's most pressing social and environmental challenges.

IMPACT OF UNDERLYING ASSETS/ ENTERPRISES

INVESTOR'S CONTRIBUTION

		A	B	C
	Does or may have significant effects on important negative outcomes for underserved people or the planet	**Act to avoid harm** Prevent or reduce significant effects on important negative outcomes for people and the planet	**Benefit stakeholders** Have various effects on important positive outcomes for people and the planet	**Contribute to solutions** Have a significant effect on specific important positive outcome(s) for underserved people or the planet
1 **Signal that impact matters** + Engage actively + Grow new/ undersupplied capital markets + Provide flexible capital	By 2030, c.10% of the bond market is invested in green or social bonds. By 2030, c.25% of the market capitalisation of public companies is aligned with the Sustainable Development Goals			$12 trillion* in bonds; $20 trillion in public equities
2 **Signal that impact matters** + Engage actively + Grow new/ undersupplied capital markets + Provide flexible capital	By 2030, c.15% of private equity is growing and actively engaging with portfolio companies to increase their positive impact on pressing social or environmental challenges			$400 billion in mainstream private equity
3 **Signal that impact matters** + Engage actively **+ Grow new/under-supplied capital markets** + Provide flexible capital	By 2030, c.15% of real estate and infrastructure investments are enabling construction of affordable homes and other essential infrastructure in places where they are most needed			$500 billion in real estate and infrastructure
4 **Signal that impact matters** **+ Engage actively** **+ Grow new/under-supplied capital markets** + Provide flexible capital	By 2030, nearly half of all venture capital is backing entrepreneurs that have developed innovative social or environmental solutions, such as bringing better education or financial literacy to underserved markets			$300 billion in venture capital
5 **Signal that impact matters** + Engage actively **+ Grow new/under-supplied capital markets** **+ Provide flexible capital**	By 2030, social impact bonds have scaled to deliver significant improvement in better outcomes for targeted hard-to-reach populations, such as reduced offending rates or homelessness.			$800 billion in Social Impact Bonds
6 **Signal that impact matters** **+ Engage actively** **+ Grow new/under-supplied capital markets** **+ Provide flexible capital**				

The continued growth* in active engagement by both fixed income and public investors means that a significant percentage of this capital could work to improve the impact of companies and projects on people and the planet

As an innovative investment product, without a proven track record, SIBs have been kick-started by investors that are willing and able to take apparently disproportionate risk (given the capped level of financial return, which is usually set by the outcomes-payer). Over time, however, it is possible that SIBs prove to be an investment opportunity capable of delivering predictable and competitive risk-adjusted financial returns, rather than requiring flexible capital. If so, given the return drivers of many SIBs (an investor's financial return is dependant on whether, for example, children achieve better exam results, rather than on the price of oil), they may have a lower correlation profile to the rest of the market. These features could make SIBs particularly attractive to investors seeking less correlated returns.

See reference list in the full report which can be found on the GSG website: https://gsgii.org/wp-content/uploads/2018/11/GSG-Paper-2018-WideningDeepening-the-Market-Nov.pdf

Source: The Impact Management Project, 2018