GiveSmart

Frequently Asked Questions About Philanthropy

What Is Impact Investing and Why Should or Shouldn't Philanthropists Consider It?

Collaborating to accelerate social impact

www.GiveSmart.org

Impact investing has become a hot topic among donors and financial investors alike. But what does it mean, and why might you consider it as a philanthropic option? Broadly defined, *impact investing* means investing capital to generate social impact in a way that also provides monetary returns. These returns may vary from the initial principal amount upward (or, potentially, downward), depending on the nature of the investment.

Impact investing offers an alternative to philanthropists who reject the notion that there is a binary decision between investing for profit and giving money to a social cause. While traditional grantmaking often overcomes market-based failures, impact investing leverages the power of markets to create change. As you think about the social problems you seek to address, consider impacting investing as one of the many tools at your disposal. However, keep in mind that impact investing is in its infancy and relatively unproven.

Consider impact investing as one of the many philanthropic tools at your disposal, but keep in mind that impact investing is in its infancy and relatively unproven.

Types of impact investing

Impact investing is an umbrella term that encompasses vehicles for a wide range of investors. For example, a microfinance investor, a green-tech venture capitalist, and a low-income housing lender are all potential impact investors. The Monitor Institute notes that impact investors can be broadly categorized into two groups:

- **Financial first investors** seek to optimise financial returns, while also aspiring to achieve social or environmental impact. This group tends to consist of commercial investors who search for investment vehicles that offer market-rate returns that also yield some social/environmental good.
- **Impact first investors** prioritize social or environmental returns on their investments over monetary returns, while still expecting some financial return. This group uses social/environmental good as a primary objective and may accept a range of returns, from return of principal to market rate. These investors are also willing to shoulder more risk in order to reach social/environmental goals that cannot be achieved in combination with financial returns at market rates.

This work is licensed under the Creative Commons BY-NC-ND License. To view a copy of this license, visit www.GiveSmart.org/AboutUs/TermsOfUse.aspx

For one overview of potential impact investing vehicles, please see "Impact across the mission-related investment portfolio," by the FB Heron Foundation.

Impact investing in action

There are many approaches to impact investing. Consider Pierre and Pam Omidyar's Omidyar Network, an organization that supports nonprofit organizations and for-profit businesses seeking to achieve social change. Omidyar Network's first for-profit equity deals included companies such as Ethos Water, which uses a share of proceeds to provide clean drinking water in India, East Africa, and elsewhere. "Businesspeople going into philanthropy or nonprofits typically have the idea that they need to 'give back,'" said Pierre Omidyar. "This implies, of course, that when they worked in the business world, they were 'taking away.' I've tried to challenge that assumption." The Bill & Melinda Gates Foundation provides another example. The foundation invested $10 million to acquire a stake in Liquidia Technologies, a biotechnology company working on new ways to deliver vaccines. The foundation bought its shares using a program-related investment, which counted towards the 5 percent of assets the foundation is required to pay out each year.

"Businesspeople going into philanthropy or nonprofits typically have the idea that they need to 'give back.' This implies, of course, that when they worked in the business world they were 'taking away.' I've tried to challenge that assumption"

–Pierre Omidyar

Jay Coen Gilbert, an entrepreneur and philanthropist, and his wife took another approach. They focused on the endowment side of their foundation, and over a five-year period, dramatically changed their investment approach. In 2001, they transitioned their foundation's funds from a portfolio focused solely on financial returns to a portfolio that took into account companies' environmental, social, and governance policies. In 2003, they placed approximately 5 percent of the foundation's assets into investments that sought to create social impact along with financial returns by investing in for-profit social enterprises. In 2006, they moved the remaining 95 percent of the foundation's money into such impact investments. "Impact and social change have emotional resonance in a way that financial returns do not," said Gilbert. (For more background on the Gilbert's decision, please see the Monitor Report.)

Potential limitations of impact investing

While there is a lot of excitement surrounding impact investing, there is also the potential that, at least at the moment, rhetoric outdistances reality. There

This work is licensed under the Creative Commons BY-NC-ND License. To view a copy of this license, visit www.GiveSmart.org/AboutUs/TermsOfUse.aspx

appear to be opportunities available, but it isn't yet time to declare a "new era." A survey from JP Morgan Chase and the Global Impact Investing Network characterized the impact investing field as "in its infancy and growing." The survey highlighted the lack of a track record of successful investments, a shortage of quality investment opportunities, and inadequate impact measurement practice. These potential challenges are significant, and may take decades to overcome. Due to the nature of these challenges, a new report by the Monitor Institute and the Acumen Fund argues that impact investing is not a replacement for philanthropic contributions, but rather a complement, helping organizations to grow once they have proven the success of their model using, frequently, philanthropic contributions.

Impact investing may have great potential, but some who have studied the nascent field are worried that the approach could undermine support for philanthropy, or fade away before it does much good. However, other philanthropists and businesspeople believe that impact investing could bring just the renewal and energy needed to address some of the world's most challenging problems. Potential investors should realize that impact investing will require significant due diligence and attention to measuring results, and that however the field emerges, traditional philanthropic contributions will continue to be necessary.

See the Givesmart.org Content Library for more Philanthropy FAQs.

SOURCES USED FOR THIS ARTICLE:

- Antony Bugg-Levine and Jed Emerson, *Impact Investing*, (Jossey-Bass, 2011).
- "Investing for Impact: Case Studies Across Asset Classes," Bridges Ventures and The Parthenon Group, 2010.
- "Investing for Social & Environmental Impact," Monitor Institute, January 2009.
- Harvey Koh, Ashish Karamchandani, and Robert Katz, "From Blueprint to Scale: The Case for Philanthropy in Impact Investing," Monitor Institute and Acumen Fund, April 2012.
- "Mission Investments," The Philanthropic Initiative, Accessed on May 7, 2011.
- Nick O'Donohoe, Christina Leijonhufvud, Yasemin Saltuk, Antony Bugg-Levine, and Margot Brandenburg, "Impact Investments: An Emerging Asset Class," J.P. Morgan, The Rockefeller Foundation, and Global Impact Investing Network, November 2010.
- Pierre Omidyar, "How I Did It: EBay's Founder on Innovating the Business Model of Social Change," *Harvard Business Review*, September 2011.
- Jon Pratt, "Social Impact Bonds: A Conversation with Simon Jawitz," *The Nonprofit Quarterly*, November 2011.
- Frank Roger, "Impact Investing: What Exactly Is New?", *Stanford Social Innovation Review*, Winter 2012.
- Yasemin Saltuk, Amit Bouri, and Giselle Leung, "Insight into the Impact Investment Market," J.P. Morgan and Global Impact Investing Network, December 2011.
- Stephanie Strom, "To Advance Their Cause, Foundations Buy Stocks," *New York Times*, November 2011.

This work is licensed under the Creative Commons BY-NC-ND License. To view a copy of this license, visit www.GiveSmart.org/AboutUs/TermsOfUse.aspx