Chapter 1

A MIGHTY WAVE

- An investor in Hong Kong wants to secure her children's economic future. But she also wants to use her wealth to address the social and environmental challenges she cares about and thereby leave a deeper legacy. She becomes convinced that simply giving her money away cannot be the only way she can make a difference. So she redirects her assets into investments that preserve her wealth and also directly tackle problems of poverty and environmental degradation.
- A group of friends volunteering for a nonprofit organization look for ways to help reduce poverty in rural Mexico. They stumble onto the idea of lending small amounts of money to poor people who cannot access loans from banks. But they struggle to secure donations and instead take on loans. When their success exhausts their available charitable capital, they convert to a for-profit enterprise and eventually hold an initial public offering on the Mexican stock market that raises more than $300 million. Suddenly they find themselves in the middle of a global media storm, lionized as saviors and vilified as greedy capitalists.
- A senior investment banker in New York decides to shift career tracks to contribute to the fight against global poverty. But instead of leaving Wall Street to do it, she sets up a unit in one of the world's leading finance firms to

> provide banking services to enterprises around the world that tackle the issue of poverty. Within a week of the announcement of the unit's creation, nearly a thousand employees of the investment bank contact her to offer to collaborate in this work.

It's easy to miss these pioneers in the crowded and complex worlds of investment and traditional philanthropy. After all, a lot has been going on in both worlds recently. And maybe these individuals are just eccentrics we can easily ignore. Perhaps they are just barely visible and unimportant ripples atop the roiling waves we seem to find ourselves in so often these days.

We believe they are something more. These ripples are related and part of a shifting tide. These three people are pioneers in the rapidly evolving global industry of impact investing, as are the many other people you will meet in this book. Each of them is discovering a new realm of possibility. They are maximizing the total value of their investments and organizations, creating a high-octane blend of economic performance and sustained environmental and social impact. And their discoveries are upending long-held and jealously guarded beliefs that profit-making and charitable activities must be kept separate in isolated silos of thinking and practice.

These are the early signs of a long-forming undercurrent that is poised to reshape how society deploys its resources and solves its problems. As Robert Kennedy famously noted, even tiny ripples can become a powerful current that sweeps aside the established order when they are multiplied and brought together. Powerful in its simplicity, the idea of impact investing for blended value—investment strategies that generate financial return while intentionally improving social and environmental conditions—is disrupting a world organized around the competing principle that for-profit investments should seek only to pursue financial return, while people who care about social problems should give away their money or wait for the government to step in. But one person's disruption is another's opportunity. Impact investing pioneers are jumping into these fast-flowing waters, creating new enterprises, ideas, and approaches to match the aspirations of investors and entrepreneurs eager to harness the full power of capital.

This book describes how impact investing is rising around us as the various ripples come together, the disruptions it is causing, and the opportunities it presents. The grand global swell of impact investing is growing as the dynamics that precipitated the movement gather force. We cannot predict what will happen when this water crests. But we will all be well served to develop the insights and strategies that can ready us for the changes it will bring.

Impact Investing for Blended Value: A Definition

Impact investing recognizes that investments can pursue financial returns while also intentionally addressing social and environmental challenges. Despite, or perhaps because of, this simplicity, it can seem threatening to some people. Many mainstream investors reject the idea that they should pay attention to the social impact of their investing, insisting instead that these considerations be left to governments and charities. And for their part, most traditional philanthropists reject the idea that they should use their investments to advance their mission or that businesses generating profits have a right to stand alongside philanthropy and civil society in the noble work of promoting equality and justice.

But impact investing is not a modern aberration. The idea that our investment decisions can have an impact on the wider world beyond financial return did not begin when Jed first described "blended value" in 2000 or when Antony was part of the group that coined the phrase "impact investing" seven years later. In many ways, it reconnects with a centuries-old tradition that held the owners of wealth responsible for the welfare of their broader community. It is a story that goes back at least to the Quakers in seventeenth-century England who sought to align their investment and purchase decisions with their values. It is linked as well with the Shaker congregations in the 1800s that launched businesses in alignment with social values and to fund religious communities. It traces its arc through the environmental movement of the 1970s, the anti-apartheid divestment campaigns of the 1980s, and the modern fair trade consumer and socially responsible investing movements. In one form or another, aspects of impact investing have been playing themselves out on the global stage for centuries. What we see before us today is simply its latest iteration, linking economics with social and environmental aspects of the human experience.

What *is* new is that impact investors are profoundly optimistic about the role business can play in advancing the common good and the leverage that social enterprises can achieve by applying financial tools. We see business practices as a powerful force that can be harnessed for good rather than a necessary evil that must be curtailed. This optimism is not ideological: we are not capitalist triumphalists, eager to spread the gospel of free market greatness to the far corners of the world. Moreover, we are not ignorant of the limits of market-based strategies for social change. But we have observed what is going on in diverse corners of an increasingly connected planet. And we cannot help but marvel at how many people in both rich and poor countries enjoy a better life because of successful profit-seeking investment.

We also know that new challenges require new approaches. Every one of us is confronting the shared reality that regardless of who is in political office or what the latest social trend is, our social and environmental challenges are too vast and our financial resources too limited for our current approaches to work. We can no longer afford to waste capital and talent by organizing ourselves around the separate poles of financial return and social good, which forces us to play the middle against itself. Instead blended value offers a new way to integrate our activity around the recognition that we do not seek appropriate wealth *or* social justice; rather, we seek both.

We are neither purely economic creatures nor social beings. By extension, all of our organizations have elements of financial, social, and environmental performance embedded within them, regardless of whether they are for profit or nonprofit. The sooner we recognize that and organize our public persona and institutions around this basic, seemingly self-evident truth, the sooner we will be able to move beyond the bifurcated approaches to both investing and social change that have dominated our world over past centuries. They have locked us into supposed solutions that have failed to consistently move our communities into a sustainable, just, and personally powerful future.

What's in a Name?

When Jed first heard the term *impact investing*, he cringed and thought, *Yet one more buzzword created by newcomers without the patience to understand what the existing terms and practices really mean*. He felt it was just a new addition to the litany of terms having greater and greater importance to ever decreasing slices of an isolated community where empty words and rhetoric were growing like weeds, making it difficult for others to move through the thicket and on to a clearly defined path. He felt *impact investing* to be just one more reason to spend more time hiking and less time in meetings, conferences, and strategy workshops. We imagine others may share that initial reaction, and so it's worth pausing to explain why we use the term here and how we think it is different from labels of the past.

This current use of the term *impact investing* came out of a set of discussions Antony held with a group of investors in 2007, all of them making impact investments before the term existed. They were early investors in green technology and the first institutional investors who placed equity into microfinance funds. They had launched creative loan structures for low-income housing developers in U.S. cities and were managing public equity investments on a sustainable basis. What unified all of them was an interest in assessing the potential and real performance of their capital through more than a passive financial lens. They wanted to use their capital to do something positive.

And terms in use did not capture fully these investors' interest in defining investing as an active verb. *Socially responsible investing* and *ethical investing* seemed burdened with moral obligation or personal, normative judgment and a history of negative screening that focused on what type of firms to avoid. *Sustainable finance* seemed narrowly focused on environmental concerns rather than the full array of social justice and development issues and seemed also to muffle the excitement these investors felt regarding their possibilities. And although *community development finance* resonated with some Americans, it did not capture the breadth of global investing in which these actors engaged, did not connect with locally focused investors outside the United States, and did not reflect the premium many place on environmental issues or investment opportunities.

Impact investing, however, evoked the optimism and action orientation of this group. The term provided a broad, rhetorical umbrella under which a wide range of investors could huddle. The microfinance investor, the green-tech venture capitalist, the low-income housing lender: all could now see their affinity in a broader movement and begin to collaborate to address the similar challenges they faced. With an intentional double meaning, the term has also cast a wide net. Some impact investors are content just to make investments that directly create social and environmental impact. Others want their investments ultimately to have an impact on how all investment is conducted. The term has resonated as well with a new set of investors who have sensed a desire to integrate their investment and philanthropy but previously lacked the language to articulate it.

What an Impact Investment Is

Defining exactly what is (and what is not) an impact investment has become increasingly important as the term has taken off. And, unfortunately, many people approaching this task are still locked in old language and mind-sets. They are used to orienting themselves around financial return and therefore define impact investments as below-market-rate investments that trade off financial return for social impact. Although these investments certainly form part of the impact-investing universe, the heart of the movement is the reorientation around blended value as the organizing principle of our work: using capital to maximize total, combined value with multiple aspects of performance.

For now, the industry is coalescing around a definition that focuses on intention and the attention an investor pays to blended value returns: impact investors intend to create positive impact alongside various levels of financial return, both managing and measuring the blended value they create.

What does this mean in practice?

All investments are capable of generating positive social impact, but some are closer to the action than others. Public equity investors can generate impact, for example, through a shareholder advocacy campaign, and investors pursuing this approach have had meaningful impact on some corporate practices. Indeed, virtually all the impact investors we know place a portion of their portfolio in impact-oriented public equity funds. In this way, impact investing is a strategy across all asset classes. But the shortest line we can draw between our investment choices and their social impact is to place capital directly into companies and projects and make loans and private equity investments as the vehicles to do so. Therefore, the impact investing movement tends to focus on venture investing, private equity and direct lending because of the unmatched power of these investments to generate social impact.

Of course, not all venture or private equity investments are impact investments, even when they seem to focus on high-potential sectors or geographies. Simply putting capital to work in a poor country does not qualify an investor as an impact investor. Funds and firms earning a seat at the impact investment table focus on strategies that intentionally seek to uplift rather than exploit poor customers and treat impact reporting as a central business management practice—not an afterthought for external reporting and marketing. Similarly, a clean energy investment that inadvertently destroys critical habitat could destroy rather than create value. These distinctions matter to impact investors who are developing strategies to allocate capital where it can generate the most integrated, blended value.

What Blended Value Is

If impact investing is what we do, blended value is what we produce. Value is what gets created when investors invest and organizations act to pursue their mission. All organizations, for-profit and nonprofit alike, create value that consists of economic, social, and environmental components. All investors, whether market rate, charitable, or some mix of the two, generate all three forms of value. But somehow this fundamental truth has been lost to a world that sees value as being only economic (created by for-profit companies) or social (created by nonprofit organizations or government). And most business managers, as well as investors, miss out on the opportunity to capture their total value potential by not managing for blended value on an intentional strategic basis.

The concept of blended value reintegrates our understanding of value as a nondivisible combination of these three elements. Blended value is its own distinct force to be understood, measured, and sought. It is not just something we can achieve by adding up its component parts because it is more than the sum of the parts of a triple-bottom-line analysis. At the same time, blended value does not mean one loses the distinct taste and flavors of the component ingredients of value creation. It is not a blurring of these components, and the components do not lose their unique attributes and characteristics. It is not a weaving together of separate parts, but rather a recombining of core elements that, through their natural integration, transform into a new, stronger, and more nuanced organizational and capital structure. Blended value is the recognition that capital, community, and commerce can create more than their sum and is less a math exercise of zero-sum pluses and minuses than a physics equation of an expanding universe of investments in organizations, people, and planet.

The Coming Disruption

Impact investing has gained its foothold following an historic period of upheaval in the capital markets. In fact, the financial crisis of 2008 precipitated the largest impact investments of all time. Just like pioneering impact investors, governments around the world recognized the need and opportunity to go beyond donations in their scramble to protect jobs and social stability by shoring up private companies. They invested tens of billions in loans, equity investments, and guarantees, the basic tools of the impact investors that we describe extensively in this book. And the forces that set off the first ripples of the impact investing movement continue to grow:

- With gathering intensity, wealthy investors and philanthropists have become impatient with old approaches in the face of intractable and increasingly visible environmental damage and poverty.
- A new generation of business and socially savvy entrepreneurs is launching ventures across an array of geographies and sectors that creatively structure investment

capital to tackle society's challenges and pursue new market opportunities.

- Cash-strapped governments are redefining their relationships with private business as demographic realities force a reexamination of fundamental components of the social contract.
- The rise of online social networking platforms creates the potential for thousands of investors to talk, share, and engage with each other as they identify, vet, and place investments in social entrepreneurs the world over.

These forces are finding their outlet in impact investing for blended value. Implementing this simple concept is not easy. Although impact investors see the opportunities in an integrated approach, our systems have not yet caught up. Frustration abounds as the old only grudgingly gives way to the new.

The current of impact investing is washing along the shores of a bifurcated world still organized to separate profit making from social and environmental problem solving. For now, this bifurcated world channels the energy of impact investors into the hidden pools and underground rivers on the margins of mainstream investment and philanthropic activity. But water has a powerful ability to reshape the world it flows through. The gathering weight of impact investment activity is wearing away the bedrock of seemingly immovable institutions and investment practices.

Impact investors will not long be content to force-fit their aspirations into a set of systems created to support a bifurcated vision. Instead, these systems will inevitably change under the collective weight of a new generation of investors, entrepreneurs, and government officials flowing together in the pursuit of blended value:

- In the bifurcated world, established for-profit and nonprofit business models facilitate separate profit-maximizing investments and philanthropic contributions. In the world of blended value, a new class of social enterprises will organize to maximize the full blended value of investment.

- In the bifurcated world, laws and regulations clearly define and protect traditional entrepreneurs, investors, and philanthropists. But they are ill suited to understand, yet alone guide, enterprises and investors seeking to maximize blended value. In the world of blended value, governments will determine how to harness impact investment to complement public resources in capitalizing the solutions to society's most pressing challenges.
- In the bifurcated world, leadership development systems and support services create clear pathways for talented people to navigate separate careers in charity or business. In the world of blended value, we will need new approaches to find and develop the professionals who want to apply their business savvy to create wealth and tackle social and environmental challenges together.
- In the bifurcated world, we know how to measure the value of financial investments and are getting better at describing the social impact of charity. In the world of blended value, we will create common language and measurement systems that can ensure we steer our capital and attention to the enterprises most adept at creating profit together with social value.
- In the bifurcated world, a vast array of institutions constitutes the capital markets that separately facilitate exchange between the donor and the charity and the investor and the business. In the world of blended value, these capital markets will turn to the task of connecting impact investors and social entrepreneurs.

We do not seek to overstate the changes that are occurring or the challenges in sustaining that innovation. The bifurcated world will certainly linger. For many people, separating investing and charity will continue to make sense. But some established systems will inevitably adapt. And others will become increasingly isolated as they fail to evolve in response to the new conditions, replaced by new systems that do.

The Opportunities That Impact Investing Brings

Throughout this book, we describe the disruption that impact investing for blended value is causing. For us, this disruption is exciting. What a privilege to live in a moment of fundamental transformation as people remove the blinders of habit and stale conviction. Opportunities abound for the innovators who can see clearly what is happening around us and build the enterprises and systems for the future.

In this book, you will meet some of these innovators:

- An entrepreneur building a successful business that identifies and structures impact investments for family offices and foundations
- An investment banker harnessing international capital markets to accelerate the vaccination of children in Africa
- A social entrepreneur raising rural incomes across the world by making loans that connect isolated farmers to global supply chains
- A policy advocate creating a new corporate form that allows a business to honor its social purpose while pursuing profit
- A graduate student rejecting the advice of his parents and professors to make money first and worry about the world later, and instead applying his business skills to address social challenges from the beginning of his career

You will also learn alongside these and other pioneers as they explore the principles and approaches that will flourish in this new world. By bringing together two previously separate worlds, impact investing is forging unlikely collaboration and friendships between philanthropists and venture capitalists, between investment banks and nonprofit organizations, between wealth advisors and their clients.

We hope they inspire you to join their ranks. But we do not assume you will necessarily quit your job and jump head-first to swim alongside these pioneers fording rivers into unexplored terrain. Understanding how the current of impact investing is poised to change the world is relevant even if you stay on the shore. This is your world, and you will have a stake in it regardless of where you live or how much you have to invest.

Devastation or Renewal?

First taking shape out of the sustainable investing and divestment campaigns of the 1970s and 1980s, the waves of socially responsible investing have begun to alter how executives in many industries engage with customers, regulators, and society. Impact investing grew out of the conditions these waves created and has the potential to be even more disruptive.

Currents can create devastation when they wash ashore, but they can also be forces for renewal. The annual flooding of the Nile Delta has brought sustenance to millions of people for centuries. And the pioneers of wave energy are turning ocean currents into a sustainable source of renewable power.

What will result from the current of impact investing? Will it undermine support for philanthropy and draw resources away from more productive investment? Will it bring the renewal and energy that enable us to tackle the seemingly impossible challenges we face? Or will it just fade as so many other currents have in the past before making much difference at all?

The answer will come from how we direct the current and prepare to harness its power. We will need to see the ripples for the mighty current they can become. Actors on both sides of the checkbook—investors and those receiving investment—need to recognize we are all part of something potentially more powerful than we can be alone. This is easy to affirm but difficult to put into practice. Many individual participants are only beginning to understand the full extent to which they share a basic set of approaches and values that unite them in this newly emerging capital market. We will be called on to take the leap of faith that supporting this new industry will serve us and the rest of the world better than preserving our small niches.

We must also collectively resist the danger that impact investing will become merely a marketing tool. The resonance of the term is its greatest threat. Tempted by the good intentions of clients, institutional asset managers may co-opt the spirit of impact investing by structuring investment product that appears to create value but avoids the hard work required to generate more than just nice stories with pictures.

And just like a flowing river, the current of impact investing will create opportunity that we must organize to capture. New laws, new systems for measuring value, new capital markets' innovators, new approaches to cultivating leadership: these will be the hydropower stations and the sustainable fisheries that convert this current into a powerful force. To build them will require all of us to abandon our assumptions and our self-righteousness and to collaborate with people and institutions we may have comfortably ignored in the past.

The Power of Capital

We have seen the true power of capital:

- It is the green of heavy banana bunches on the slopes of Mt. Kenya in the dry season, watered with irrigation equipment funded by a microloan.

- It is the anticipation on the face of the woman on Chicago's South Side who tapped a local community development fund to launch her bakery.
- It is the professional pride of a foundation program officer whose investment in an educational services company in New York has helped provide teachers with the tools they need to raise students' performance to heights that grants alone never could.
- It is the satisfaction of a family in India that has just moved out of a slum into a new brick home purchased from an equity-backed, low-income-housing developer.
- It is the light shining through the window of a home in rural Nicaragua that is powered by a micro-hydropower plant built with investment from a renewable energy fund.
- It is the investment banker in London signing the closing documents for a new fund that will channel client capital into businesses that provide affordable, essential services to poor people.

These are the realities we can create when we remove our blinders and realize the potential for blended value all around us. There are some clear paths and promising trails but no one way to go or right way to execute the strategy. Through this book, we invite you to come with us, to see something of the terrain, to explore parts of this promising landscape and to cut your own path.