IMPACT INVESTMENT: THE INVISIBLE HEART OF MARKETS

Harnessing the power of entrepreneurship, innovation and capital for public good

Report of the

SOCIAL IMPACT INVESTMENT TASKFORCE

Established under the UK's presidency of the G8

15 September 2014

LETTER TO LEADERS OF TASKFORCE GOVERNMENTS

In June last year Prime Minister David Cameron announced, during the UK's presidency of the G8, the launch of an independent Taskforce and set it the ambitious objective of reporting on 'catalysing a global market in impact investment' in order to improve society.

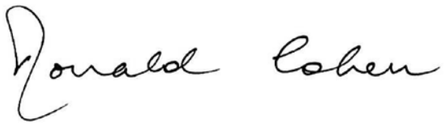
It has been a remarkable experience since then to lead an exceptionally talented and committed group of more than 200 people across the world in achieving this inspiring mission and I thank them most warmly for all they have done. The Taskforce itself comprises some twenty-two people, including one government official and one representative of the social or private sector from seven countries and the EU, as well as one observer from Australia. But to inform our work and to drive its implementation in the future, we created eight National Advisory Boards. We also established four international expert Working Groups to address in depth the particular challenges of measuring impact, asset allocation, mission in business and international development, all of which are critical to the success of our endeavour.

We are honoured to deliver to you this report together with four subject papers that provide supplementary detail on important elements of our work. Each of the National Advisory Boards also launches today its own report on what is required in its country if it is to bring impact investment to take off. Our reports have all been written with the aim of attracting as wide a readership as possible, to include all audiences interested in impact investing.

Our investigations have benefitted greatly from the insights of numerous impact-driven organisations and entrepreneurs, foundations and philanthropists, investors, businesses, government ministers and officials who have contributed their expertise and their experience to our deliberations. We are most grateful to them all. As a result, we can confirm the tremendous potential of impact investment to improve society and the environment. We note that it is already shifting the paradigm in how we think about and tackle social and environmental issues in the 21st century, in developed and in developing countries alike. The Taskforce will now continue its work for a second year to drive the take-up and implementation of our recommendations.

Our recommendations are critical to the success of impact investment. They define what is needed from all actors in our society: government, business, the social sector and foundations, institutional and private investors, and most importantly impact entrepreneurs. The role of each of these groups is addressed in this report. Impact investment is emerging as a new unifying force among them in dealing with social issues, driving innovation and prevention to improve lives. It harnesses the forces of entrepreneurship, innovation and capital and the power of markets to do good. One might with justification say that it brings the invisible heart of markets to guide their invisible hand.

Yours sincerely,



Sir Ronald Cohen
Taskforce Chair

> "I want to use our G8 presidency to push this agenda forward. We will work with other G8 nations to grow the social investment market and increase investment, allowing the best social innovations to spread and help tackle our shared social and economic challenges."

David Cameron Prime Minister, UK
World Economic Forum, Davos 2013

> "It is urgent that governments throughout the world commit themselves to developing an international framework capable of promoting a market of high impact investments and thus to combating an economy which excludes and discards."

Pope Francis, June 2014

> "This is ground zero of a big deal."

Lawrence Summers, former US Treasury Secretary,
after investing in one of the US's first social impact bonds, May 2014

GLOSSARY

AFD	Agence Française de Développement
APEC	Asia-Pacific Economic Cooperation
ASEAN	Association of Southeast Asian Nations
BSC	Big Society Capital (United Kingdom)
CIC	Community Interest Company (United Kingdom)
CRA	Community Reinvestment Act (United States)
CSR	Corporate Social Responsibility
DFI	Development Finance Institution
DIB	Development Impact Bond
DFID	Department for International Development (United Kingdom)
ERISA	Employee Retirement Income Security Act (United States)
ESG	Environmental, social and governmental
EU	European Union
G20	Group of Twenty (Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Republic of Korea, Mexico, Russia, Saudi Arabia, South Africa, Turkey, the United Kingdom, the United States and the European Union)
G8	Group of Eight (Canada, France, Germany, Italy, Japan, Russia, the United Kingdom and the United States)
G7	Group of Seven (Canada, France, Germany, Italy, Japan, the United Kingdom and the United States)
GDP	Gross Domestic Product
GIIN	Global Impact Investment Network
GIIRS	Global Impact Investing Ratings System
GRI	Global Reporting Initiative
IFC	International Finance Corporation
IPO	Initial Public Offering
IRIS	Impact Reporting and Investment Standards
IRS	Internal Revenue Service (United States)
JICA	Japanese International Cooperation Agency
MRI	Mission-related investing
NAB	Taskforce National Advisory Board
OAS	Organisation of American States
OECD	Organisation for Economic Co-operation and Development
OPIC	Overseas Private Investment Corporation (United States)
PRI	Programme-related investing
SASB	Sustainable Accounting Standards Board (United States)
SEC	Securities and Exchange Commission (United States)
SIB	Social Impact Bond
SRI	Socially responsible investment
SSE	Social Stock Exchange
UN	United Nations
UNPRI	United Nations Principles for Responsible Investment
US	United States of America
WEF	World Economic Forum
WG	Taskforce Working Group

In this report, the Taskforce uses the following terms and definitions:

Impact-driven organisations
Organisations that hold a long-term social mission, set social outcome objectives and measure their achievement, whether they be social sector organisations or impact-driven businesses.

Impact-driven businesses
Profit-with-purpose businesses or Businesses-seeking-impact that set significant outcomes objectives and maintain them in the long-term. They have no asset lock.

Social sector organisations
Impact-driven organisations with partial or full asset-lock. For example: charities that do not engage in trading; charities and membership groups that trade but do not distribute profits; social and solidarity enterprises; cooperatives; and other profit- or dividend-constrained organisations.

Profit-with-purpose businesses
Businesses that lock in social mission through their governance and/or embed it in their business model.

Businesses-seeking-impact
Businesses that set and maintain social outcome objectives for a significant part of their activities, without locking in their mission.

Social impact entrepreneur (also known as social entrepreneur and impact entrepreneur)
Entrepreneur leading an impact-driven organisation, be it a social sector organisation or impact-driven business, to achieve social impact.

Contents

Available separately:

Explanatory Note
- Policy Levers and Objectives

Subject Papers
- Measuring Impact
- Allocating for Impact
- Profit-with-Purpose Businesses
- International Development

National Advisory Board Reports
- Australia, Canada, France, Germany, Italy, Japan, UK, USA

The Social Impact Investment Taskforce is an independent taskforce launched in 2013 under the UK's presidency of the G8. Over the last fourteen months, it has brought together government and sector experts from the G7 countries, the European Commission and Australia to fulfil its mandate to report on 'catalysing a global market in impact investment'.

This report presents a summary of the Taskforce's key findings and recommendations. It does not necessarily reflect the individual opinions of members of the Taskforce, its Working Groups or its National Advisory Boards, or the official positions of the organisations and governments they represent.

STRUCTURE OF THE SOCIAL IMPACT INVESTMENT TASKFORCE

SOCIAL IMPACT INVESTMENT TASKFORCE

- Government officials and representatives of the social and private sectors from seven countries and the EU
- Observer representative from Australia and OPIC as a representative of Development Finance Institutions

National advisory boards

- Domestic membership from within each Taskforce country
- Created to inform the work of the Taskforce and to drive future implementation across Taskforce geographies and beyond
- National Advisory Boards were established in Australia, Canada, France, Germany, Italy, Japan, United Kingdom and United States
- Each National Advisory Board has published its own report on what is required in its country to bring impact investment to take-off

Working groups

- International membership from across Taskforce countries and beyond
- Created to inform the work of the Taskforce
- Tasked to address challenges critical to catalysing impact investment: measuring impact, asset allocation, mission in business and international development
- Each Working Group has published its own Subject Paper and recommendations to accompany the Taskforce Report

OECD Report

- To complement the work of the Taskforce, the OECD is undertaking an exercise mapping the global impact investment sector and expected developments
- Preliminary findings are anticipated to be published in Autumn 2014

Impact Measurement
Objective: To assess the scope and process for using outcome metrics and to recommend approach and principles for measurement of social outcomes

Asset Allocation
Objective: To recommend approach and principles needed to achieve specific allocation to impact investment by institutional investors

Mission Alignment
Objective: To examine ways of securing social mission for profit-with-purpose businesses through corporate form, governance or legal protections

International Development
Objective: To recommend approach and principles for application of social impact investment in international development

INTRODUCTION

THE NEW PARADIGM

The world is on the brink of a revolution in how we solve society's toughest problems. The force capable of driving this revolution is 'social impact investing', which harnesses entrepreneurship, innovation and capital to power social improvement.

It is already bringing significant advances in areas such as reducing prisoner reoffending, caring for children and the elderly, community regeneration, financial inclusion, and supported housing. It has the potential to generate great benefits in developed as well as developing countries.

Social impact investing, impact investing for short throughout this report, encompasses environmental impact. It is at the core of a broad 'impact continuum', that runs from philanthropy to responsible and sustainable investment, which includes all those seeking to achieve positive impact. Impact investment is growing fast. The amount invested by the 125 leading impact investors is forecast to grow by nearly 20% this year, according to the latest study by the *Global Impact Investment Network (GIIN)* and *JP Morgan*.[1] Given that $45 trillion are in mainstream investment funds that have publicly committed to incorporate environmental, social and governance factors into their investment decisions,[2] it would only need a small fraction of this money to start moving into impact investment for it to expand rapidly along the growth path to the mainstream previously taken by venture capital and private equity.

Social Impact Investments are those that intentionally target specific social objectives along with a financial return and measure the achievement of both.

The financial crash of 2008 highlighted the need for a renewed effort to ensure that finance helps build a healthy society.

This requires a paradigm shift in capital market thinking, from two-dimensions to three. By bringing a third dimension, impact, to the 20th century capital market dimensions of risk and return, impact investing has the potential to transform our ability to build a better society for all.

It is arriving at a time when a generational shift is taking place in how people, especially younger people, see their role in solving society's problems.[3] Doing good and doing well are no longer seen as incompatible. There is a growing desire to reconnect work with meaning and purpose, to make a difference. This is leading to an increasing supply of people looking for employers with an explicit commitment to improve the world. There has been a rapid rise globally in the number of impact entrepreneurs who want to find innovative ways to solve society's problems, and they are increasingly deploying the methods of business and private capital if that helps them to do so. They include people in the social sector who can now tap the markets for finance in addition to seeking grants from donors, and philanthropists who are willing to fund businesses rather than social sector organisations if that offers a greater likelihood of achieving the social impact they desire. They are leading a shift in philanthropy from a focus on the act of giving to the impact it achieves.

This new approach is built on a number of shared beliefs: that, in some cases, investment can be more effective than donations in helping the poor; that social motivations harnessed to financial ones can sometimes do good more effectively; and that in many situations there is no inevitable trade-off between financial and social return.

It is also becoming ever clearer that there is an increasing need for innovative and effective solutions to society's problems. Impact investment is a response to the growing awareness in both the public and private sectors that the challenges facing society in the 21st century are too large and too complex to be solved by government and the social sector alone. Old problems are proving more resistant than expected to efforts to solve them, whilst some problems such as diabetes and recidivism are taking on a new urgency and may well prove cheaper to prevent than the costs of dealing with their consequences.

So despite their different models for tackling social and environmental challenges, governments everywhere are under ever greater pressure to make meaningful progress in tackling the social problems facing their countries. All of the countries on the Taskforce also face growing pressure, in a context of fiscal restraint, to allocate government spending more efficiently and effectively to social needs.

1 J.P. Morgan and the GIIN, Spotlight on the Market: The Impact Investor Survey, May 2014
2 UN Principles for Responsible Investment, PRI Fact Sheet. Available at: www.unpri.org/news/pri-fact-sheet
3 Deloitte, The Millennial Survey 2014, Available at: www.deloitte.com/MillennialSurvey

Impact investing does not relieve governments of their responsibilities. But it can help to fulfil them more effectively. By financing innovative approaches, impact investing also has the potential to help deliver services more efficiently and, in some cases, tackle the underlying causes of growing demand for social services instead of just trying to cope with their consequences.

Impact investing can also greatly strengthen social sector organisations. Until now these have had to make their essential, and often considerable, contribution to society without access to the full range of financing options available to regular businesses. Although there are outstanding examples of big, impactful social service organisations, too many struggle to make the large scale impact that the success of their methods deserves. Impact investment, with its emphasis on scaling up activities that achieve measurable social outcomes, can transform how social sector organisations are financed, and in doing so make it likelier that they will succeed in achieving their mission at significant scale.

Impact investing is already starting to make an important difference. But it needs to grow fast if we are to meet the challenges now facing the world. That is why in June 2013, as part of the UK's presidency of the G8, this independent Social Impact Investment Taskforce was established.[4] Our recommendations are the result of work over the past 14 months by hundreds of people around the world from the public, social and private sectors, who have collaborated with the Taskforce and its eight National Advisory Boards (NAB) and four international expert Working Groups (WG) focused on the main barriers to the global spread of impact investment.

Our recommendations are addressed to a wide range of actors that can help to grow impact investment. These include governments, private philanthropy, business and social sector organisations, as well as individual savers who want to use their money to help build a world fit for their children and grandchildren to live in. For all of them, impact investment offers the opportunity to help bring a profound cultural change in the way we deal with society's problems.

Many of our recommendations are addressed to government, which in every country is called to play a number of important enabling roles: as a market-builder, by upgrading its ecosystem to better support impact investment; as a large purchaser of social outcomes that can drive pay-for-success; and as a market steward, to remove legal and other barriers to impact investing and ensure that the positive intentions of impact investment are sustained over time. Most of the policies we recommend involve no additional government spending, whilst those that do should generate benefits over time that far exceed their cost.

Even within the countries engaged in the Taskforce there are significant differences in relevant laws, practice and culture, and in the relative roles of the state, business and social sector organisations in dealing with society's problems. This affects the nature and form of the ecosystem for impact investment. Our recommendations take these differences into account, mostly by setting out principles that can be applied everywhere and so help to catalyse a truly global market for impact investment. Where there are specific proposals that are only suited to one or a few countries, we say so. Country-specific recommendations are set out in the reports of each NAB.

Impact investment, like any market, is a combination of demand (for capital to finance impact-driven organisations), supply (of impact capital) and intermediaries (helping to connect supply and demand). The principal components of the impact investment ecosystem are:

- **Impact-seeking purchasers** – these provide the sources of revenue that underpin investment in impact-driven organisations. Such purchasers can include governments, consumers, corporations or foundations.
- **Impact-driven organisations** – all types of organisations which have a long-term social mission, set outcome objectives and measure their achievement, whether they be social sector organisations or impact-driven businesses.
- **Forms of finance** – which are needed to address a range of different investment requirements.
- **Channels of impact capital** – to connect investors to impact-driven organisations in situations where the sources of impact capital do not invest directly in impact-driven organisations.
- **Sources of impact capital** – to provide the investment flows needed.

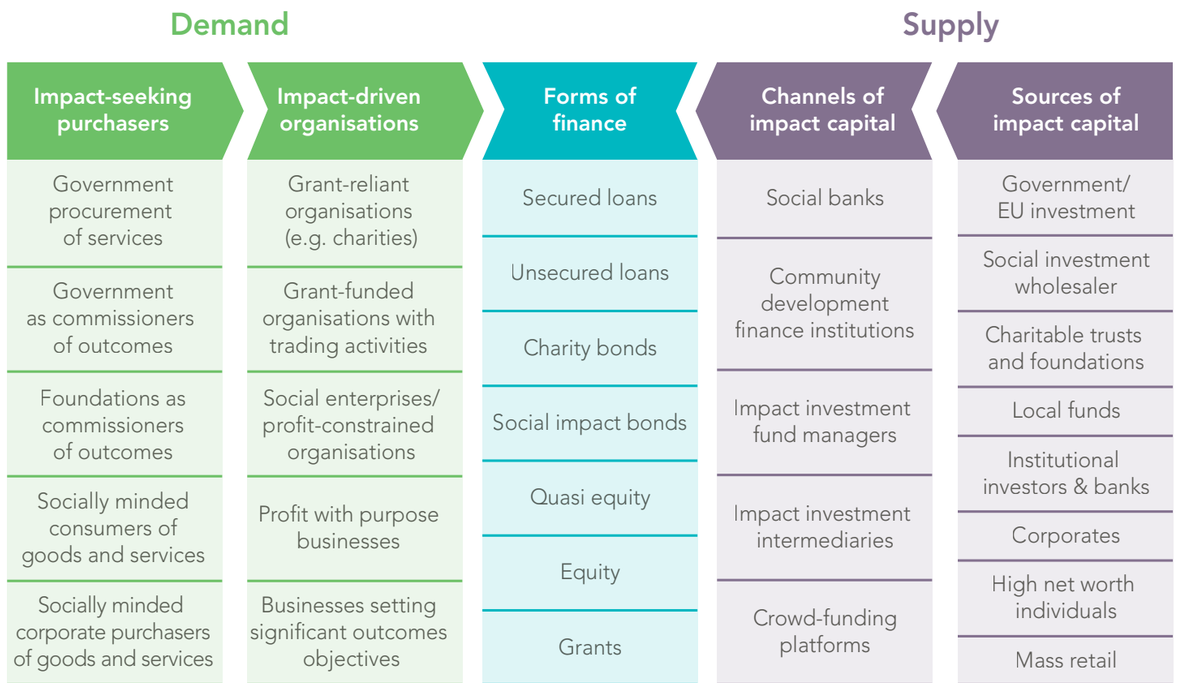
The diagram on the next page provides a schematic overview of the ecosystem.

In each country, the ecosystem varies according to the role of government, foundations, the private sector, individual investors and the social sector. These differences affect the driving forces behind impact investment. For example, in France and Italy, the social sector is the driving force and in Japan it is large corporations.

The ecosystem and the related policy options available to governments are outlined in the Explanatory Note for Policymakers.

4 www.gov.uk/government/groups/social-impact-investment-taskforce

SOCIAL IMPACT INVESTMENT ECOSYSTEM



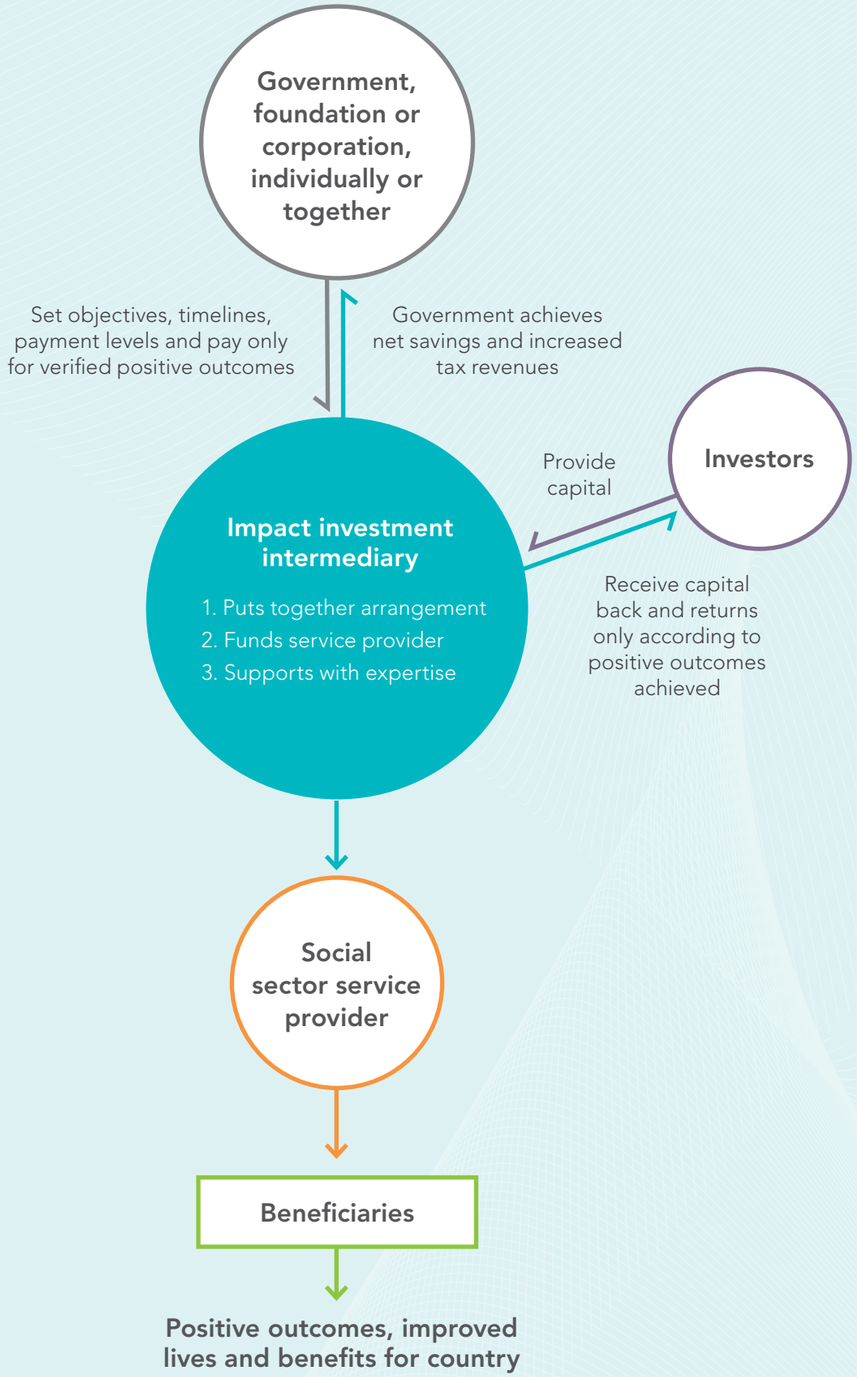
Not everything we propose is new. In some countries, aspects of impact investing have a long history (such as community development finance in the US, the credit union and Quebec social economy movements in Canada, or the thriving cooperative movement in Europe). Modern philanthropic institutions such as the *Bill & Melinda Gates Foundation (Gates Foundation)* have been at the forefront of experimenting with market-based mechanisms and using financial innovation to create sustainable social change. The work of the *Gates Foundation* to introduce Advance Market Commitments for vaccines, for example, has contributed to their widespread and low-cost distribution across the developing world through its clever application of market economics. However, everywhere we think there is a need, and opportunity, to do much more. By following the relatively simple, inexpensive and practical steps set out in this report, we believe there is the potential quickly to unleash up to $1 trillion of new investment to tackle social problems more innovatively and effectively.[5]

Our recommendations fall into the following chapters. **The Age of Impact Entrepreneurship** focuses on removing constraints on the growth of organisations established or now led by impact entrepreneurs. Those who seek to deliver impact need better recognition and better tools and support to get things done at scale. This includes mechanisms to protect social mission in businesses, such as the new benefit corporation structure that is catching on among impact entrepreneurs in the US and many other countries. In this chapter, we describe six key ways that the legal system can help impact entrepreneurs achieve scale, only one of which is currently available in every Taskforce country. In this respect, we think every country can make progress.

There is also huge potential in every country for government, as a 'commissioner' of social services and impact, to help scale social sector start-ups into organisations that deliver significant impact. The recent innovation of social impact bonds (SIB), initially in the UK and now in many other countries, could drive the development of a market in which

5 Impact Investments: An Emerging Asset Class, J.P. Morgan and the Rockefeller Foundation, November 2010, pp. 6 and 11

WHAT IS A SOCIAL IMPACT BOND?



government, philanthropic foundations and, perhaps, others can agree in advance to 'buy' specific social outcomes delivered by impact-driven organisations. We set out proposals to accelerate the development of this market.

The next chapter, **The First Trillion**, focuses on how to remove barriers to the flow of capital into impact investment. Our recommendations are relevant to all investors, but especially foundations and pension funds. There should be no room for doubt that trustees responsible for other people's money can be prudent and responsible when they incorporate impact alongside risk and return in their decision making. More particularly, foundations and charitable trusts established by wealthy individuals, as well as the investment management activities of banks and sovereign wealth funds, have the opportunity to play an especially catalytic role in the impact marketplace by investing an appropriate portion of their portfolios more actively in pursuit of their chosen social mission. Foundation assets across the world are very considerable, representing some $150 billion in the US, £100 billion in the UK, €100 billion in Germany and approaching $44 billion in Canada, with many prominent foundations outside these countries such as the *Aga Khan Foundation* and the *Gulbenkian Foundation.*

The following chapter, **The Third Dimension**, focuses on perhaps the most important enabler of this new paradigm, impact measurement. Starting in the 1930s, there was a concerted effort by governments and the private sector to develop better economic and business data, to enable policymakers, investors and corporate managers to better understand and manage performance. Today, there should be a similarly concerted effort to incorporate the measurement of social and environmental impact into the performance reporting of governments, business and the charitable sector. This will be a challenge. There will be no perfect measures of impact. But that is no different from our measures of the economy and financial risk. As with them, the goal should be to develop measures that are good enough to be useful. The better we measure impact, the more capital will be invested in achieving it.

The chapter describing **A New Force in International Development** deals with the fact that our recommendations are not exclusively about helping the world's leading economies to do a better job of solving their 21st century problems. Impact investment may have even greater potential for helping developing countries to simultaneously achieve better social outcomes and economic growth, both by incorporating it in their domestic policies and by giving it growing prominence in international aid and foreign investment. We make several recommendations, including exploring the potential for 'development impact bonds' to address social constraints on economic development, including illiteracy, sickness and unpreparedness for employment.

The final chapter, **Galvanising a Global Impact Movement**, identifies action to be taken by national governments, international institutions, foundations, mainstream investors, and other important actors, including individual citizens, in developing a thriving impact investment market capable of delivering potentially huge direct benefits in the form of better social outcomes.

As the global impact investment market grows, governments will not only have access to vast new pools of capital but also the ability to share in the entrepreneurship and innovation expertise of business and the social sector. ***This is not about increasing or reducing public expenditure, but rather about helping government do more with the money it has.***

Entrepreneurial leaders in the social sector will gain access to the finance they need in order to scale up their ideas, in similar ways to those which entrepreneurs in the for-profit sector have long taken for granted. In the business world, there will be rapid growth in impact-driven regular businesses and 'profit-with-purpose' companies with an embedded social mission and measurable objectives whose achievement is tracked. Philanthropic foundations will have new ways to deploy some of the capital in their endowments to achieve their social missions. Investors will potentially gain a valuable new set of less correlated investment opportunities and the financial sector a chance to rebuild trust with the public by demonstrating it can be a powerful force for social good and help deliver inclusive economic growth that benefits everyone.

The success of our efforts will itself be measured, by the size of capital flows into impact investment from foundation endowments, mainstream investment institutions, wealthy individuals and the general public; the spread of outcomes commissioning by governments, foundations and businesses, directed at achieving specific social objectives; the number of successful impact-driven organisations created; the number of impact-driven organisations that achieve impact on a significant scale; the number of impact investment managers; and the development of supportive market infrastructure, including ratings agencies and social stock exchanges. The NAB reports explore in more detail what is required to build the market in each country.

The ultimate test is whether impact investment delivers better outcomes on social issues and improves millions of lives across the world.

HIGH-LEVEL RECOMMENDATIONS

1

Set measurable impact objectives and track their achievement

2

Investors to consider three dimensions: risk, return and impact

3

Clarify fiduciary responsibilities of trustees: to allow trustees to consider social as well as financial return on their investments

4

Pay-for-success commissioning: governments should consider streamlining pay-for-success arrangements such as social impact bonds and adapting national ecosystems to support impact investment

5

Consider setting up an impact investment wholesaler funded with unclaimed assets to drive development of the impact investment sector

6

Boost social sector organisational capacity: governments and foundations to consider establishing capacity-building grants programmes

7

Give Profit-with-Purpose businesses the ability to lock-in mission: governments to provide appropriate legal forms or provisions for entrepreneurs and investors who wish to secure social mission into the future

8

Support impact investment's role in international development: governments to consider providing their development finance institutions with flexibility to increase impact investment efforts. Explore creation of an Impact Finance Facility to help attract early-stage capital, and a DIB Social Outcomes Fund to pay for successful development impact bonds.

THE AGE OF IMPACT ENTREPRENEURSHIP

One of the strongest reasons to be optimistic about the outlook for impact investment is the growing number of impact entrepreneurs applying their creative energy to find innovative and sustainable ways of addressing social problems. There is an untapped latent supply of the talent needed to build successful impact organisations.

Members of the millennial generation that is entering the workforce today want their work to have a purpose beyond merely making money, whilst older generations too are ever less willing to settle for a compartmentalisation of how they earn a living and how they want the world to be.[6] At the same time the demand side is growing as 'impact-seeking purchasers' including consumers, governments, philanthropists and others increasingly seek out goods and services that demonstrably make the world a better place.

> "Members of the millennial generation that is entering the workforce today want their work to have a purpose beyond merely making money, whilst older generations too are ever less willing to settle for a compartmentalisation of how they earn a living and how they want the world to be."

This sea change is reflected in the blurring of old lines between working in the for-profit and social sectors. Social sector organisations increasingly look to increase their impact and sustainability by generating revenues and embracing some best practices from business, and a growing number of companies claim a social purpose beyond profit. It is evident, too, in the growing number of people who are themselves creating organisations to address some of our biggest challenges. Today, impact entrepreneurs can often be found where tough problems have created a pressing need for social innovations.

With its focus on achieving demonstrably better outcomes, impact investing has the potential to give every organisation with a social mission a better chance of success. This includes social sector organisations that want other sources of capital besides traditional grants from charitable donors or government and businesses that decide to put a social mission at the core of their business model.

Impact investment moves us away from the traditional misconception that the same organisation cannot pursue both profit and social impact. Government regulations which have typically focused on public versus private benefit as the clear differentiator of social impact are starting to adjust to these new approaches, but need to go further.

Some of the leading impact entrepreneurs have created thriving social sector organisations. Sal Khan now provides online tuition to 10 million people a month through his *Khan Academy*. Andrew Youn helps train 200,000 small farmers in Africa through the *One Acre Fund* he founded. In recent years, they have been joined by a growing number of impact entrepreneurs who pursue social innovation by starting for-profit companies, such as Kristin Richmond and Kirsten Tobey, the founders of *Revolution Foods*, which provides one million healthy meals each week to school children across the US, 75% from low-income families, and Dirk Mueller-Remus, who founded *auticon*, a Berlin-based business with a mission to train people with Asperger syndrome and find them work in IT departments. Some have already achieved scale through hybrid models, such as *Groupe SOS* in France which has 11,000 employees, €900 million of revenues and at least one million beneficiaries of the work of its constituent organisations in meeting a range of social needs. In Italy, the *CGM Consortium* includes 900 social enterprises, 42,000 employees, 800,000 beneficiaries and €1.2 billion of revenues.

6 Deloitte, The Millennial Survey 2014, Available at: www.deloitte.com/MillennialSurvey

A vibrant social sector will include small and large social sector organisations. Impact investing can help entrepreneurs take their good ideas to scale, much as the emergence of a large venture capital industry in several countries over the past four decades has led to a huge increase in the number of entrepreneurial start-ups growing into big, successful companies. Impact investing comprises all forms of financing linked to social objectives, from seed and early stage risk capital all the way through to debt and growth capital. The need for this full range of financing forms has become all too clear. In the US, for example, over the past 25 years or so, whereas over 50,000 new businesses have passed the $50 million revenue mark, only a meagre 144 social sector organiations have succeeded in doing so.[7] It is time for the social sector to start catching up.

> "There has been a steady increase in the number of social sector organisations that raise revenue through government contracts or by charging for services or products they supply."

The emergence of impact investing is happening at least partly as a result of the increasing efforts of social sector organisations to generate revenues, rather than depend solely on grants. Where they have been allowed to do so, they have been growing more rapidly, driven in part by government contracting, which has been rising.

Developing a thriving social sector to use the capital deployed by impact investors is about far more than helping entrepreneurial start-ups, of course. There are opportunities to increase the impact of established organisations, too. In Australia, for example, impact investors provided A$95 million to purchase a large private provider of early learning and childcare services and turn it into a large scale social sector organisation, *Goodstart*, which runs 641 centres catering for 73,000 children.

To accelerate the growth of a thriving impact sector, it is important for governments to understand the range of choices impact entrepreneurs must make in starting organisations dedicated to achieving societal goals, and the pros and cons of the different legal forms their organisations can take. They should ensure that laws, regulations and fiscal incentives work to encourage, rather than hinder, choices that allow for the greatest social impact.

SOCIAL SECTOR ORGANISATIONS

Social sector organisations already account for more than 5% of GDP in several countries, including Canada, Germany, the UK and the US. In some countries, they employ more than 10% of the workforce.[8] We believe that this will increase significantly, as will the productivity of the social sector, as the impact investment market grows. In certain countries, such as France and Italy, there is a broad sector called the 'social and solidarity economy' which includes charitable 'associations', cooperatives, mutuals and impact-driven businesses, some of which will be suitable for impact investment. In France this social and solidarity economy employs 2.3 million people, and its importance has recently been recognised in legislation.[9]

Any impact-driven organisation can be a recipient of impact investment, provided it can deliver social impact and financial return. A grant from a donor is not impact investing, however, as there is no expectation of a getting any of the money back, let alone of earning a financial return on it.

The growth of social sector organisations has accelerated in recent years, as government contracting to them has risen. In the UK, for example, more than 80% of government funding received by charities is now in the form of contracts for delivering services rather than grants to support their work, reaching over £11 billion a year in 2011/2012.[10] In Germany, a codified welfare system with legally guaranteed funding streams has enabled the growth of a large social sector, which is at the heart of delivering government funded social provision. In Italy, the social sector accounts for 15% of national GDP and 10% of the total workforce.[11]

There has been a steady increase in the number of social sector organisations that raise revenue through government contracts or by charging for services or products they supply, from hospitals to international development organisations. For example the *San Patrignano* centre for drug rehabilitation in Italy raises revenue through selling products produced by the young people living there and following its programme. In 2012, *Oxfam International's* 1,200 stores in 9 countries generated revenues of €178 million, and a net surplus after costs of €31 million.

There remains a pressing need to help individual social sector organisations, and the social sector as a whole, to develop the capacity required to make good use of impact investment capital. Just as

7 W. Foster and G.Fine, 'How Nonprofits Get Really Big', Stanford Social Innovation Review, (Spring 2007) 5(2), pages 46-55
8 See, for example, Roeger, K, Blackwood, A and Pettijohn, S, 'The Nonprofit Almanac', The Urban Institute (2012) page 35; and Statistics Canada, Satellite Account of Nonprofit Institutions and Volunteering, 2009. Available at: www.sectorsource.ca/resource/file/satellite-account-nonprofit-institutions-and-volunteering-2007
9 European Commission (2012) Social Economy: Laying the Groundwork for Innovative Solutions to Today's Challenges, Synthesis Report, France, 10-11 December 2012, page 16.
10 NCVO, UK Civil Society Almanac (2014), page 29. Available at: www.data.ncvo.org.uk/a/almanac14/how-has-the-funding-mix-changed/
11 Istat 2014, Censimento dell'Industria e dei Servizi 2011, Istituzioni Non profit

traditional businesses now benefit from a vast ecosystem spanning bankers, management consultants, lawyers, accountants, public relations firms, and business schools, impact delivery organisations will need help in identifying opportunities to draw on impact investment and support in reaching across the cultural chasm that often divides the social sector from the finance industry.

A related challenge is the type of financing that social sector organisations usually get. For-profit start-ups have traditionally received funding from venture capitalists and others that allows them the flexibility to finance their growth. By contrast, the vast majority of grants to social sector organisations are allocated entirely to a specific project. This constrains social sector organisations from investing in their organisation's operational capacity – whether through hiring the right executive talent, or creating back-office infrastructure that improves efficiency. In the US, for example, only 16% of grants given out each year are for general operating support.

> "Equally remarkable is the number of entrepreneurial start-ups emerging that have social mission at the heart of their organisation and the variety of business models they use."

One promising development has been the emergence of 'venture philanthropy' firms that seek to apply many of the 'hands-on' capacity-building techniques of venture capital to social sector organisation start-ups – including providing general operating support, mentoring, help with recruitment, strategic thinking and embedding a revenue model from the start.

Among the leading examples in the US are: *New Profit Inc; Social Venture Partners; Venture Philanthropy Partners; SV2;* and *Draper, Richards, Kaplan*. The *European Venture Philanthropy Association* boasts over 170 members, such as *Impetus-PEF* in the UK and others as far afield as Turkey and the UAE. The *Asian Venture Philanthropy Network* has more than 160 members from 28 countries and Japan now has its first comprehensive venture philanthropy fund, *JVFP,* founded by private equity and corporate finance professionals in 2013 and jointly managed by the *Nippon Foundation* and *Social Investment Partners*.

After over a decade of experimentation and learning, and notable successes such as *Teach for America* and *Kiva*, venture philanthropy seems poised to play a more significant role in social sector organisations, helping prepare them to put impact investment capital to work.

For the social sector to achieve its potential, there will need to be a dramatic increase in the organisational capacity of social sector organisations and in their ability to attract management talent and deploy investment capital.

To accelerate the ability of social sector organisations to deliver social impact, some governments, foundations and companies have contributed financial and human resources to help them. Foundations are well placed to assume the leading role in achieving this.

Capacity-building can be supported in a number of ways, from technical support to incubator funds. Partnerships with established big companies have also proved fruitful. *The B Team*, a group of prominent business leaders, including Sir Richard Branson, Arianna Huffington and Paul Polman, is emerging as a champion of impact entrepreneurship across the world, joining leading convening organisations such as the *Clinton Global Initiative*, the *Skoll World Forum* and the *World Economic Forum* in actively supporting the development of impact entrepreneurship. The annual *SOCAP (Social Capital Markets)* gathering in California has become an important knowledge exchange for the field. In addition, growing interest in the *Global Learning Exchange*, launched at the G8 Social Impact Investment Forum in 2013, has shown how important it is to have global platforms that can connects people, ideas and resources in order to share best practice and build the impact investing market.

PROFIT-WITH-PURPOSE BUSINESSES

Many young people today believe that the number one purpose of business is to benefit society, and 50% of them say they want to work for a business with ethical practices, according to recent surveys of millennials by *Deloitte*.[12] There has been a rapid increase in the number of businesses that put a social mission at the heart of their business model. They are challenging a traditional scepticism in many countries about the mixing of profit with the tackling of social issues.

Existing businesses, big and small, are also recognising the importance of a greater focus on achieving social impact. There are a growing number of big companies that now take seriously their environmental, social and governance responsibilities. There are grounds for optimism in the adoption of ideas such as 'shared value', advocated in recent years by Michael Porter of Harvard Business School, where businesses seek to incorporate into their business model both making a profit and bringing a clear benefit to society, and the proliferation of partnerships between big business and leading social sector organisations, such as *Dow Chemical* and the *Nature Conservancy, Danone* with *Grameen* and *Nestle* with the *Fair Labour Association*.

Equally remarkable is the number of entrepreneurial start-ups emerging that have social mission at the heart of their organisation and the variety of business models they use. Companies such as *d.light, Microensure* and *Barefoot Power* create products (solar lighting, microinsurance and affordable renewable energy, respectively) that have a direct impact on underserved populations. What is more, these impact entrepreneurs have taken pioneer risks to prove that there are indeed large market opportunities in addressing these problems. As a result, they are now able to attract large amounts of investment capital to grow. Others have chosen different business models to benefit underserved populations. For example, *Tom's Shoes* and *Warby Parker* have built into their business model a 'buy a pair, give a pair away' cross-subsidisation, with shoes and eye glasses respectively. In this model purchases from richer customers finance needed goods for poorer customers.

> "A growing number of entrepreneurs see advantage in having their impact certified. Certification organisations verify impact and the use of responsible business practice for companies, providing a seal of excellence that can help motivate employees, provide transparency to stakeholders, and send a proactive message to customers."

Entrepreneurs starting impact-driven businesses have a number of choices to make in terms of how they structure their business to achieve the most impact. Many, especially those who sell product with impact 'baked into' the business model, choose to use standard for-profit tools (such as the limited liability corporation) so as to appeal to the widest mix of mission driven and conventional investors – and thereby maximise their opportunity to raise capital for growth. There are many examples of such impactful businesses. In the US, *Progreso Financiero* empowers Hispanic individuals and business owners with limited or no credit history by offering credit-building loans at affordable rates. This impact-driven company has received more than $175 million from leading impact investors and venture capitalists and has distributed more than a billion dollars in loans to underserved populations. In the environmental domain, *Opower* is a company that combines a cloud-based platform, big data, and behavioural science to help utilities around the world reduce energy consumption and improve their relationship with their customers. The enterprise has reached 32 million households and saved more than 5 billion kilowatt hours of electricity; it recently had a successful initial public offering (IPO). And *Indiegogo*, along with *Kickstarter,* has democratised access to funding with its online platform that has allowed millions of small-scale artists, community builders, inventors and innovators to mount crowdfunding campaigns that extend well beyond their own individual networks, thus greatly increasing their odds of success. The Indiegogo website has over 9 million visitors each month with campaigns started in 224 countries.

A growing number of entrepreneurs see advantage in having their impact certified. Certification organisations verify impact and the use of responsible business practice for companies, providing a seal of excellence that can help motivate employees, provide transparency to stakeholders, and send a proactive message to customers. There are more than 1,000 'B Corps' around the world, including notable companies, such as *Ben & Jerry's, Change.org, Etsy* and *Patagonia*.

Another emerging practice is that of incorporating a new business using a special legal structure designed to protect the mission of that business, even through a change in management or ownership. Impact entrepreneurs may find it beneficial to have such a legal 'mission lock' when, for example, raising money from public or quasi-public sources, or to attract other forms of socially driven investment. In the US, the legal 'benefit corporation' structure was first adopted in Maryland in 2010 and is now law in 27 States.[13] The idea is also generating interest abroad. Although this is a relatively new phenomenon, we are hopeful that such mission-locked organisations will be especially attractive to social impact investors as well as mainstream ones. We recommend that governments create legal structures that offer impact entrepreneurs a choice of corporate vehicles that give them the best shot at fulfilling their social mission.

12 Deloitte, The Millennial Survey 2014, Available at: www.deloitte.com/MillennialSurvey

13 www.benefitcorp.net

CATALYSING IMPACT ENTREPRENEURSHIP

Governments can play an important role in catalysing the growth of impact entrepreneurship. Regardless of whether they are social sector organisations or impact-driven businesses, the most common obstacle faced by impact entrepreneurs is securing early stage risk capital. Many impact investors are willing to invest at later stage, when business models have already been proven and risks are lower; far fewer are willing to walk side by side with entrepreneurs through the critical early stages of a high-risk, high-growth impact business. It is only with this type of funding that we will be able to test and scale dynamic market-driven solutions to urgent problems. Social sector organisations, similarly, may need to secure general operating support that would allow them to pivot in response to the needs of the market they are serving, and to invest in developing robust revenue streams. Various government initiatives are helping them go in this direction.

> “Regardless of whether they are social sector organisations or impact-driven businesses, the most common obstacle faced by impact entrepreneurs is securing early stage risk capital.”

In Italy, the Prime Minister has announced the creation of a Social Fund to finance impact-driven businesses, a provision included in legislation for social enterprise being discussed in the Italian Parliament.[14]

In Japan, the government provided a $210 million grant for social innovation during 2010-2012 under the ‘New Public’ initiative, of which $86 million has gone to support 800 start-up social enterprises, while 14 intermediary organisations run a series of capacity building internship and grant programmes for seed funding.[15]

In France, the 2014 Social and Solidarity Bill aims to facilitate the financing of social sector organisations, while a social innovation investment fund for social innovation is due to be launched by ‘*Banque Publique d’Investissement*’ (a state-owned bank) and regional government entities to make loans to social innovators. The French NAB is exploring innovative ways of involving public, private and foundation resources to finance capacity building.

In the US, the White House’s Office of Social Innovation and Civic Participation is leading efforts to support impact entrepreneurs and catalyse additional private impact investment for entrepreneurs.

In the UK, the Cabinet Office created an Investment Readiness Programme, which includes an initial pool of £20 million to be deployed in capacity-building grants for investment readiness. This consists of a £10 million ‘Investment and Contract Readiness’ fund, which helps social ventures access impact investment of at least £500,000, or win contracts over £1 million; and a £10 million ‘Social Incubator Fund’ to support social incubators to provide investment and support to early stage social ventures. To date, the Investment Readiness programme has helped over 100 frontline social ventures unlock almost £100 million in investments and contract values and created 10 social incubators, which will support over 600 start-up ventures. In addition, the UK Government has recently confirmed £60 million to ensure capacity building funds for social sector organisations over the next decade.

The NAB in Germany established as part of this Taskforce suggests exploring mechanisms of risk-mitigation/risk-sharing for potential social impact investors. The NAB sees a potential role for promotional banks in this context. Primary application fields are deemed to be issues such as care for the elderly and long-term unemployment.

There are also a number of ways to unlock early-stage risk capital for impact entrepreneurs at no new cost to governments. The US NAB reviewed existing federal policies and found a number of instances in which a small tweak in programme design could unleash billions towards impact. For example, the US ‘EB5’ visa programme allows foreign investors to get green cards by investing $500,000 and creating at least 10 jobs in economically troubled areas. In 2012 alone, this programme generated $1.8 billion in investment. With a few small tweaks around the rules for qualification, the government could both expand this pool and channel an important portion of it towards impact entrepreneurs.

The US NAB identified a number of specific recommendations to make funding for entrepreneurial organisations agnostic of corporate/charitable status. For example,

14 www.avvenire.it/Commenti/Pagine/Impresa-sociale-per-ripartire.aspx
15 www5.cao.go.jp/npc/pdf/torikumi0906.pdf(Cabinet Office 2012); www5.cao.go.jp/npc/pdf/youbou.pdf(Cabinet Office 2013)

CHART A:
SIX STEPS TOWARDS SECURING THE SOCIAL MISSION OF A PROFIT-WITH-PURPOSE COMPANY

US social sector organisations are currently ineligible to apply for the nearly $15 billion of federal loans to small businesses – even if they have substantial revenue streams. A small change in regulation allowing social sector organisations to apply could make a world of difference.

A similar review could be conducted in every country of regulations that reflect old thinking about the social sector organisation/for-profit divide and which prevent money from flowing into mission driven entrepreneurial organisations. In some countries there are legal constraints on social sector organisations generating revenues. In Canada, for example, the current rules do not recognise the value of revenue generating activity among charities and non-profit organisations. In some cases, administrative guidance and interpretive rulings have gone so far as to imply that non-profit organisations can never intend to generate a profit. We recommend that all countries consider ensuring a permissive legal environment that, within reason, allows social sector organisations to generate income.

Finally, the Taskforce found that impact entrepreneurs should have access to a full range of choices in terms of the legal form in which they incorporate their business. The Taskforce Mission Alignment WG conducted a review of legal protections for entrepreneurs who wish to lock-in their mission. It found six different ways in which the legal system can provide support for this goal. (See Chart A). It highlights intent, duties and reporting as defining characteristics of a profit-with-purpose business, the commitment being to continue to deliver impact over the long term and to report on the impact created. Taskforce countries have all been moving in the direction of providing a supportive environment, but there remains plenty of scope for further action.

The Mission Alignment WG has set out several recommendations for enabling a choice of mission-lock. Its recommendations are published in its Subject Paper, *Profit with Purpose Business.*

The ability to go public is likely to be important if the benefit corporation, or other profit-with-purpose legal structure, is to emerge as a viable alternative to traditional corporate forms. It may be that the ability to list on a ‘social stock exchange’ would make it easier for such firms to conduct an IPO, and attract impact investors who are motivated to protect and advance the social mission of the firms in which they invest. Social stock exchanges have begun to emerge. The oldest and most established is the *Impact Investment Exchange (IIX)* in Asia, which was established in 2005. The IIX was developed to be Asia’s first private and public platform for social enterprises to raise capital. In 2013 it incorporated *Nexii*, a social stock exchange in South Africa. It aims to help direct much-needed growth capital to social businesses across Asia and Africa. The *Social Stock Exchange* in London (SSE) was launched in 2013 to connect impact-driven businesses with impact investors. A team in Berlin is in the process of developing a German social stock exchange, *NExT SSE*. In Canada, a social venture exchange has been created, *SVX*, which seeks to connect social ventures, impact funds, and impact investors.

PAYING FOR OUTCOMES

Impact-driven organisations need access to markets in order to generate income from the products and services they offer.

Such markets can be consumer facing. In the UK, for example, the most common main source of income for social enterprises is trade with the general public and close to half of all social enterprises now trade with the private sector too.[16] The UK Government has worked to help such impact-driven organisations gain more exposure to retail customers and commercial businesses, through campaigns such as Social Saturday (a day dedicated to encouraging consumers to buy and invest socially) and supporting online databases which enable corporations to procure from impact-driven organisations.

The largest markets, however, could be provided by governments paying for impact. There is an urgent need for a revolution in government purchasing, with paying for the successful delivery of specific outcomes at its core. A decisive move to focus on purchasing outcomes (whether by governments or other entities) is the clearest way of stimulating a flow of revenue to impact-driven organisations that rewards them more directly for the social value they create. This can have a profound effect on the way impact is delivered, as well as ensuring that innovation and effectiveness are incentivised. We believe there is a huge opportunity to create better outcomes for society,

> “There is an urgent need for a revolution in government purchasing, with paying for the successful delivery of specific outcomes at its core...ensuring that innovation and effectiveness are incentivised.”

and investible opportunities, by expanding the role that governments and philanthropic foundations play as buyers of specific outcomes from impact-driven organisations.

Governments have traditionally favoured a ‘fee-for-service’ approach in buying from social sector organisations or private firms, where a certain number of services or goods are purchased for an agreed price. An alternative involves the government (or some other purchaser) paying only when a particular social outcome has been achieved. This approach, commonly known as a ‘pay-for-success’ contract (often financed by a SIB), can help governments get more from their budgets by reducing the cost of failure and by encouraging greater creativity and innovation in outcome delivery.

The speed with which the idea of the SIB is catching on around the world is a sign that a focus on prevention and the willingness to pay for outcomes could become a huge source of demand for social sector organisations. In the UK, for example, the annual cost to the government of a convicted youth offender is around £21,268. The cost of a successful intervention that prevents reoffending may be as little as £7,000,[17] making it very attractive for the government to fund prevention in this area. The same would appear to be true for many social issues including children going into care, drop-out rates from school and university and prevention of Type 2 diabetes.

Yet established practice can often make it hard to fund the sort of prevention initiatives that involve up-front public spending but do not deliver cost savings for many years. SIBs are one possible method of transferring performance risk for social projects to investors, such as preventing reoffending by prisoners, offering a way around short-termist political pressures and facilitating the creation of more effective partnerships to solve challenging problems.

The first SIB was developed and launched in the UK in 2010 by Social Finance, a leading impact finance intermediary. It tied the achievement of a measured reduction in the rate of young prisoner reoffending to a SIB yield to investors that increases as the rate of reoffending falls.

Initially, some people thought that prisoner re-offending was the only social issue that could be measured and targeted in this way. But there are now over twenty SIBs, as well as new DIBs, being prepared around the world, covering issues ranging from improvement in child and family welfare (Canada); youth employment and care of the elderly (Japan); transition out of foster parentage, support for children in care and at-risk children and a reduction in the need for out-of-home care (Australia); helping school drop outs into employment (Germany); drop-outs rates from girls’ primary schools (Rajasthan); recidivism (Peterborough UK, New York City and New York State); juvenile justice (Massachusetts); early childhood education (Utah); teen pregnancy prevention (Washington DC); prenatal care and early childhood development outcomes (South Carolina); and reduction of teenage unemployment (UK). DIBs, where the outcomes payers are foundations and international agencies rather than the domestic government, already in preparation aim to tackle malaria in Mozambique and sleeping sickness in Uganda as well as improve educational attainment in Rwanda.[18]

So far, despite the buzz around the idea of SIBs, the amount of capital raised remains tiny relative to their potential, at around $100 million. That compares with £250 billion of social service delivery by government in the UK alone.

The reason SIBs are attracting worldwide interest is that governments everywhere are the biggest buyer of social services and are striving to deliver maximum impact from their expenditure. Whereas traditional procurement contracts specify every step of an intervention, SIB contracts, by paying for outcomes, leave room for innovation in driving up the quality of outcomes and reducing the cost of successful interventions. They also help public commissioners to get around the restrictions placed by government spending silos on new initiatives that cut across them. Social Outcome Funds established by government, as in the UK, provide the opportunity for government departments to address in a ‘joined up’ way issues covered by multiple government departments. This can be as important in fostering innovation as identifying new innovative approaches. In the US, in consecutive budgets, $300 million has been proposed for Pay-for-Success instruments, reinforced by two complementary legislative proposals in the US Congress.

SIBs, and outcomes-based funding in general, with the right design, can also motivate impact-driven organisations to work together and coordinate their joint activities productively, thereby raising their effectiveness, as the One Service has done at Peterborough Prison (see box).

For many involved in public sector commissioning, a focus on measurable outcomes and the involvement of private investors represents a new way of thinking. The shift from input cost efficiency to outcome effectiveness will require many cultural and capability changes within commissioning organisations. For government departments to commission pay-for-success outcomes, through SIBs or bilateral contracts with social sector organisations, means that officials must adjust their commissioning processes. New requirements on commissioners include the setting of metrics, benchmarks, levels of success-led reward for both investors and social sector organisations, and an appropriate share of potential savings for government, as well as drafting new legal agreements.

Sometimes there may be pushback from existing social sector organisations in the space that impact investment could inhabit, as they may fear their source of government revenue might be threatened. In others, there are cultural barriers against private providers, especially businesses, in the provision of social services.

Greater transparency about the fiscal value of achieving specific social outcomes would help enormously, by showing social innovators where opportunities exist to do better. We would like to

CASE STUDY

Peterborough Social Impact Bond

Social Finance launched the world’s first SIB, the Peterborough SIB, in September 2010. 17 foundations and charitable trusts committed £5 million. It was designed as a seven year pilot, to test the premise that offering comprehensive and individual support to 3,000 short-term male prisoners would help them stay out of prison and build a new life for themselves on the outside.

Social Finance set up a new service, known as the One Service, which included delivery organisations St Giles Trust, Sova, Ormiston Families, YMCA *and* MIND *to provide housing, family, health, employment and training support. The investors receive a return if the 12 month reconviction rate among Peterborough prison leavers falls by 7.5% or more over the whole project, relative to a control group. The greater the reduction in reconviction rate the higher the return to investors, capped at a maximum return of 13% per year. If the relative reduction is less than 7.5%, then investors do not get their money back and have in effect made a philanthropic donation.*

Based on the trend in performance so far, investors can look forward to getting their money back with a positive return.

16 Social Enterprise UK, The People’s Business: State of Social Enterprise Survey 2013, page 7
17 Source: www.data.gov.uk/sib_knowledge_box/toolkit
18 Investing in Social Outcomes: Development Impact Bonds, Center for Global Development and Social Finance, October 2013

CHART B:

EXAMPLES FROM UK GOVERNMENT UNIT COST DATABASE

Child Protection
Child taken into care average cost per year
£64,819

Unemployment
Job Seekers Allowance per claimant per year
£10,025

Youth Offending
Yearly average cost of a first time entrant to the criminal justice system
£21,268

Care for the Elderly
Residential care for older person per year
£28,132

Homelessness
Local authority intervention per individual per year
£8,391

Education
Exclusion from school per pupil per year
£11,192

Drug Misuse
Drug-related offending and health per addict per year
£3,631

Domestic Violence
Health and Criminal Justice cost per incident
£2,776

Source: www.data.gov.uk/sib_knowledge_box/toolkit

see other governments consider doing something similar to the UK's, which recently posted on the Cabinet Office website its cost of addressing some 640 priority social issues (see chart B). This Unit Cost Database is the result of combining knowledge from across all government departments of the likely cost of crime, education and skills, employment, health, housing, social services, and more.

This is potentially of enormous value to organisations that think they can deliver better outcomes more innovatively and cost-effectively, not least by helping them to attract impact investment to tackle these issues. Where the government is willing to pay organisations for generating substantial savings whilst delivering desired improvements in the lives of those whose needs are being addressed, as is the intention with a SIB, it creates a significant economic incentive for these organisations to raise the capital needed to tackle social issues in an innovative way.

The release of this information makes it a sort of official proxy for calculating social return in areas where the government is responsible for social outcomes (which varies significantly even among the countries that are members of this Taskforce). Say, for example, that a £10 million, five-year SIB for reducing recidivism delivers an 8% financial return and significant social impact by succeeding in rehabilitating 1,000 youth offenders, each of whom would have cost the UK government £21,268 a year. Using the Unit Cost Database gives a value for the social outcome in just the first year of £21 million, and an associated social return per annum of about 15% (internal rate of return) for the SIB.

Other governments may also find that publishing their costs generates significant opportunities for them to cost-effectively secure better social outcomes. Likewise, where non-governmental organisations, such as foundations, philanthropists and companies, are buyers of social outcomes, they could also publish their costs as a 'baseline' for impact entrepreneurs. As more of this information is made available, we predict that it will catalyse increasingly innovative activity in the achievement of social outcomes.

CONCLUSION

The entrepreneurial revolution of the past forty years has transformed our society. Now the emphasis is shifting to combining the forces of entrepreneurship, innovation and capital in order to improve peoples' lives.

Yet if mission driven entrepreneurs are to have the opportunities to do the meaningful work they desire, and to create the volume of investible opportunities desired by impact investors, a rethink will be needed of the rules governing social sector organisations and for-profit organisations and the ecosystem in which they operate. The extent of this rethink will vary greatly from one country to the next. But across countries, the revenues of social sector organisations should come to reflect more closely the social value they deliver, and a more coherent market will emerge as a result. If we get this right, we can unleash the world's next wave of entrepreneurial innovation, following on the great tech wave of recent decades.

RECOMMENDATIONS

1
Provide capability-building grants for social sector organisations.

2
Create legal forms or regulations that protect the social mission of impact-driven businesses.

3
Relax regulations that prevent social sector organisations from generating revenues.

4
Improve access of impact entrepreneurs to capital, including seed, early-stage and growth capital.

5
Broaden use of outcomes-based government commissioning.

THE FIRST TRILLION

As investors add the third dimension of impact to risk and financial return in their decision making, we expect there to be a considerable pool of capital looking for opportunities to invest in achieving measurable social impact.

Already, some 1,276 asset managers, with combined assets of over $45 trillion, have signed up to the six United Nations Principles for Responsible Investment (PRI), committing themselves to incorporate environmental, social and governance factors into their investment decision making processes.[19] We believe as better measurement and better funded impact entrepreneurs create a fuller, faster-flowing pipeline of impact investment opportunities, such asset managers will become aware of the potential for impact investment to capture a new set of growth opportunities and contribute to portfolio diversification. As the millennial generation takes on increasingly senior roles in the finance industry, and more broadly in society, an inter-generational shift in the values of those in leadership will reinforce this demand.

Even so, there are significant impediments to the scaling up of impact investment by the mainstream asset management world that urgently need to be addressed. These impediments are in three key areas: conflict of duty, both fiduciary and in compliance; investment risk factors; and barriers stemming from the nascent state of the impact investment sector, including a (perceived) lack of investible propositions, insufficient investor specialism and expertise, and disproportionate transaction costs.

DEVELOPING IMPACT INVESTING

Within the capital channelled into organisations such as those committed to PRI, at least $13.6 trillion of professionally managed assets incorporate environmental, social and corporate governance returns into their investment selection and engagement processes, generally known as socially-responsible investment (SRI).[20] There has been a significant growth in investment in sustainable businesses that implement best practice in environmental, social and governmental matters (ESG), or practice corporate social responsibility (CSR). However, this investment has tended to focus on the intentions and approaches of companies rather than on the measured achievement of specific impact goals. It takes various forms, from using 'negative screening' avoiding investments in companies that violate basic international norms to positively using ESG factors to find attractive investment opportunities. SRI addresses primarily public firms listed on stock exchanges around the world.

Impact investment stands in the middle of an impact continuum between philanthropic organisations on one side and, on the other, investors committed to taking into account social, environmental and governance factors when allocating capital to businesses. The defining characteristic of impact investment is that the goal of generating financial returns is unequivocally pursued within the context of setting impact objectives and measuring their achievement. Investment that results in impact that is marginal to a business's main activity is not impact investment, though it might be viewed as 'investment with impact'. It should go without saying that for an organisation to qualify for impact investment, its overall impact should be positive, not just its impact on a single social issue within a context of creating a more significant negative social impact elsewhere. A more detailed representation of how all these efforts overlap appears in the Subject Paper of the Asset Allocation WG, *Allocating for Impact*, while a simplified representation appears in Chart C.

Within the philanthropic sector, several foundations have played a pioneering role in developing the impact investment market, including SIBs. They include foundations such as *Arnold, Bertelsmann, Bill & Melinda Gates Foundation, Bloomberg, Case, Esmée Fairbairn, Ford, Kellogg, MacArthur, Omidyar Network, Pershing Square, Robin Hood, Rockefeller, Rothschild* and *Skoll. Rockefeller* has played a leading role. `Impact investment' was coined at a *Rockefeller* meeting in 2007. It has contributed to building the field, is a leading foundation of the GIIN, and has been an early advocate and supporter of SIBs. The *Omidyar Network*, another prominent leader, has deployed upwards of $700 million as an early stage impact investor, and a similar amount in social sector venture philanthropy, as well as investing in capacity-building of the impact investment sector. In the UK, the Prince of Wales and his foundations have been among the earliest supporters of SIBs.

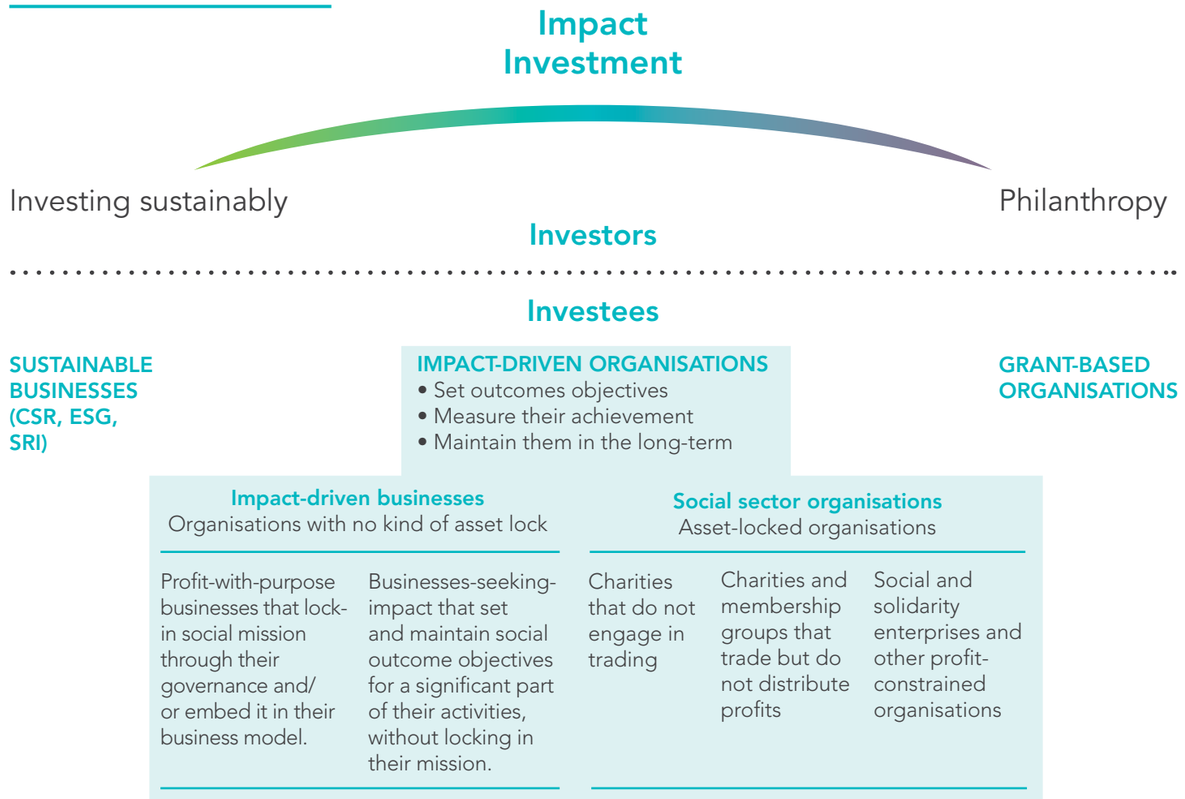
19 UN Principles for Responsible Investment, 'Signatory assets top US$45 trillion". Available at: www.unpri.org/pri-signatory-assets-top-us-45-trillion/
20 Global Sustainable Investment Alliance, 2012 Global Sustainable Investment Review, 27 January 2013, page 9. Available at: www.gsi-alliance.org

In Italy, huge banking foundations such as *Fondazione Cariplo*, which together hold €41 billion in total assets, are starting to engage in impact investing, while in Japan corporate foundations such as the *Nippon Foundation* and the *Mitsubishi Foundation* are starting to get involved (see case study on page 20).

Mainstream investment banks such as *Goldman Sachs*[21] and *Bank of America Merrill Lynch*[22] have participated in issuing SIBs to tackle prisoner recidivism in New York City and New York State, and *UBS* has launched a DIB to reduce drop-out rates from girls' primary schools in Rajasthan, with the *Children's Investment Fund Foundation* as the outcomes payer.[23] *Morgan Stanley* has created an 'Investing with Impact Platform' offering clients a range of investment vehicles evaluated for financial integrity and return as well as social impact, and a framework for evaluating the social impact from investment products which it aims to grow to $10 billion in five years.[24] *BlackRock*, the world's largest investment manager, has also developed impact investment products. Specialist banks such as Europe's *Triodos*, which started over 30 years ago with a focus on environmental issues, have participated in issuing SIBs, including for the provision of services to unemployed teenagers in Liverpool and the alleviation of homelessness in London. In Italy *Banca Prossima, Banca Etica* and *Extrabanca* are all engaged in impact finance, alongside *Federcasse* – the cooperative banks network – which is very active in providing microcredit and funding impact-driven businesses.

Ideas are travelling fast around the world. In the UK, after consultation, *Big Society Capital*, a provider of wholesale capital for impact investment, was endowed using £400 million of unclaimed assets held by banks. A potential untapped source of impact finance across the world may well lie in the unclaimed assets of dormant bank accounts,

CHART C:
THE IMPACT CONTINUUM



21 www.goldmansachs.com/what-we-do/investing-and-lending/urban-investments/case-studies/social-impact-bonds.html
22 www.newsroom.bankofamerica.com/press-releases/global-wealth-and-investment-management/bank-america-merrill-lynch-introduces-innovat
23 www.ubsphilanthropy.economist.com/innovations-in-philanthropy-development-impact-bonds/
24 www.morganstanley.com/globalcitizen/investing-impact.html
25 Policy paper of the Liberal Democratic Party 2013. Available at: www.jimin.ncss.nifty.com/pdf/sen_san23/j-file-2013-06-20-3.pdf.
See also National Council for Utilising Unclaimed Assets: www.kyumin.jp/media/pickup/

CASE STUDY

Corporate Foundations

The earthquake and tsunami that devastated eastern Japan on 11th March 2011 prompted some of the country's biggest companies to try to help rebuild the region's economy, through place-based impact investing. They included the giant Mitsubishi Corporation, which established a Disaster Relief Foundation with a ¥10 billion ($100 million) fund to invest in creating jobs and reviving industry. By this June 2014, the fund had made equity investments and extended loans to a wide range of projects, including rebuilding a hotel in Rikuzentakata City and purchasing equipment for a 200-year-old soy sauce brewing firm.

life assurance policies and pension funds. The ruling party of Japan is proposing legislation to help resolve social problems as well as to release unclaimed assets. France is currently preparing a draft law on the use of unclaimed assets.[24]

IMPACT OPPORTUNITY FOR MAINSTREAM INVESTORS

Innovative businesses backed by venture capital are now an important focus of investment managers, having been small and marginalised only 40 years ago. Likewise, impact investment, as a response to the need for innovation in tackling social issues, can be expected to create a new set of attractive investment opportunities that behave differently from traditional investments.

> "There is a prospect that the performance of some impact assets will have lower correlation or be totally uncorrelated with other assets."

There have already been several precedents for this in impact investment. The Community Development Finance industry in the US has raised billions of dollars, mostly for investing in real estate in poorer parts of the country.[26] Impact investment funds run by firms such as *Bamboo Finance* and *Leapfrog Investments* have helped direct many millions of dollars to microfinance institutions providing services to customers at the bottom of the pyramid in the developing world ranging from credit to savings and insurance. In significant segments of the microfinance industry, invented and established through the pioneering efforts of Muhammad Yunus, the performance of these investments suggests they may prove uncorrelated in important respects with that of traditional investments, making them attractive as a way of diversifying risk in investment portfolios.

The search for investments in companies that serve the poorest 25% of the UK by *Bridges Ventures*, an impact investment firm, led to the design and financing of new business models that are more price-sensitive and less capital-intensive than those developed in the mainstream economy. This included *The Gym*, a company offering no-frills facilities, open 24/7, at a quarter of the price charged by gyms in more affluent areas. While delivering a social impact through encouraging a healthier lifestyle for those in disadvantaged communities (a third of *The Gym's* customers were previously unable to afford a gym membership), the firm has grown over the past six years, during a particularly difficult time for the British economy, from a green-field start-up to a company with a £100 million valuation.

SIBs and DIBs are being designed to provide an opportunity to earn net annual returns of 7-10%, and offer the prospect of having low correlation with the rate of economic growth in their country, movements in the local stock market or interest rates. With this in mind, *QBE*, an Australian global insurer, recently made an allocation of A$100 million over 3 years to social impact, particularly to SIBs and other innovative investment instruments that link social performance and financial return.

The Asset Allocation WG has drawn on the expertise of investors and investment managers to propose a framework for portfolio construction that includes impact investment in portfolios without compromising their risk and return characteristics. Their Subject Paper, *Allocating for Impact*, shows how impact investment can enhance a diversified asset portfolio managed by a mainstream investor such as a pension fund. It demonstrates that options to add value to the classic portfolio by including impact investments exist across all asset classes: impact equities, impact fixed income and impact alternative investments.

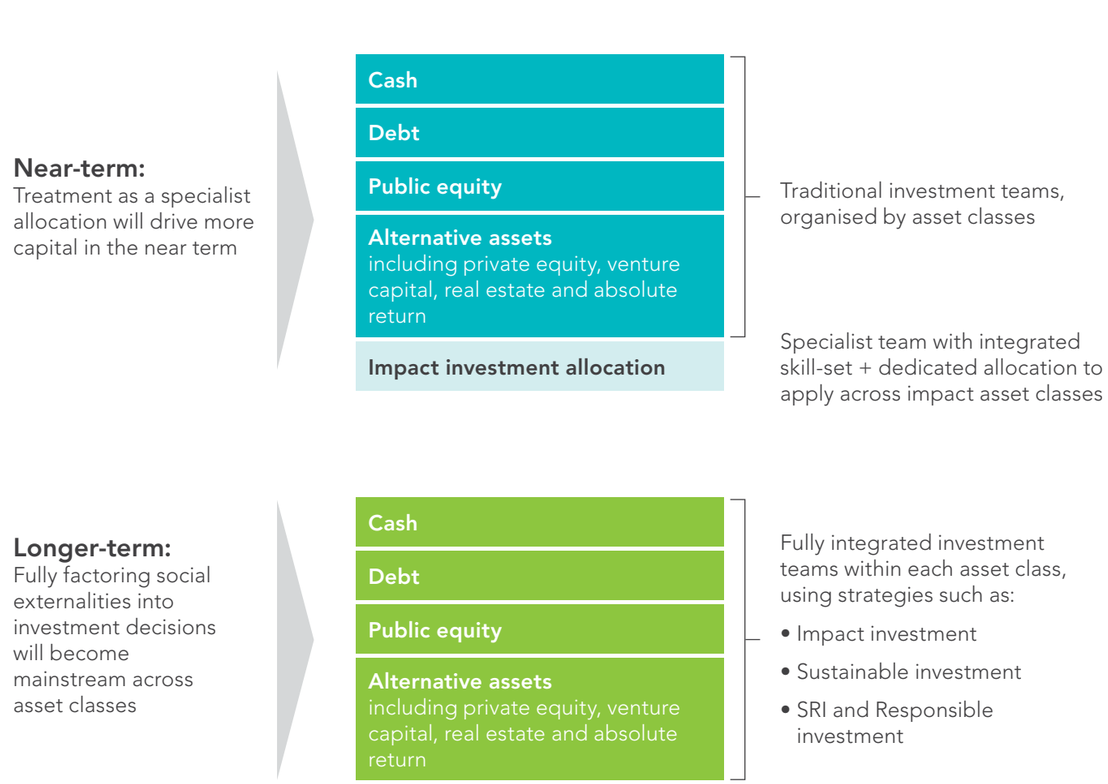
26 www.cdfi.org/

The Asset Allocation WG concluded that, at this early stage in the development of impact investing, many of the most attractive opportunities are likely to fall into the category of 'alternative investment', such as impact venture capital, impact private equity, impact real estate and impact absolute return (which will include SIBs and DIBs). Over time, it expects to see impact investments play a role in every asset class, as impact businesses list on public stock markets and there is a proliferation of specific outcome related fixed-income instruments, such as the 'vaccine bonds' issued by the *Global Alliance for Vaccines and Immunisation* to provide more predictable funding for immunisation programmes.[27]

The Asset Allocation WG recommends that impact investment should be considered a strategy that can be applied across a variety of asset classes. However, as a nascent strategy, given the additional skills required to analyse social factors alongside commercial ones, some asset owners are choosing to treat impact investment as though it were an asset class, often including it within alternative investments. In the near term, this treatment of impact investment as a specialist allocation may be useful, since dedicated teams, with an integrated skill-set and specific budget to invest, may catalyse greater allocation.

If, as the Asset Allocation WG argues, there is a prospect that the performance of impact assets may have lower correlation or be totally uncorrelated with other assets, as well as the potential for growth that is less affected by traditional business cycles, then engaging in impact investing should be a more straightforward decision than it may initially appear.

IMPACT INVESTMENT IN PORTFOLIOS



27 www.iffim.org/Library/News/Press-releases/2013/IFFIm-issues-US$-700-million-in-3-year-floating-rate-Vaccine-Bonds/

IMPACT AND FIDUCIARY RESPONSIBILITY

In many countries, various legal or regulatory impediments hold back the development of impact investment. Key among these is the definition of the duties of trustees of charitable foundations and those of pension funds (or, at least, what fiduciaries commonly believe those duties to be). There is a need for a clear 21st century definition of these responsibilities. In some places this will require legislative or regulatory changes. In others it will require the clarification of existing laws and regulations.

For foundation trustees, there should be a clear duty to factor impact into investment decisions and reporting. Pension funds are a huge potential source of impact investment capital. Changing the ERISA rules in the US, and similar rules elsewhere, to make it clear that prudent pension fund managers can and should look to make impact investments will potentially release large amounts of capital. The worldwide shift now under way towards defined contribution pension plans would create the possibility of significant flows of personal savings into impact investment by giving the general public the ability to allocate an appropriate portion of their portfolios to it. This could be a big driver of the development of a large retail impact investment market.

> “The duty of charity trustees when making a social investment is to obtain the best overall return from the investment, and that is not limited to a purely financial return. Instead, it should be based on the combination of the financial benefit from the transaction and the extent to which the transaction achieves the charity’s purposes.”
>
> **UK Law Commission Consultation Paper ‘Social Investment by Charities’**

There are already notable examples of pension funds becoming interested in impact opportunities. Quebec’s workers funds (e.g., *Fonds de Solidarité and Fondaction*) are engaged in some impact investments, as is the *Teachers’ Retirement System of the City of New York (TRSNYC)*. In June 2014, five of the largest UK local authority pension funds together committed £152 million to social impact investing through a joint ‘Investing 4 Growth’ fund.

In the same way that US pension funds turned into cornerstone investors in venture capital and private equity funds following a change in 1978 in the prudent man rule embodied in the ERISA regulations, we believe that a clear signal from governments everywhere to foundations and pension funds, could lead to large amounts of capital flowing to impact investments. Governments with Sovereign Wealth Funds making it clear to their managers that they have a similar responsibility would add to these flows.

IMPACT INVESTING AND PHILANTHROPY

Given their commitment to improving society, individual philanthropists and charitable foundations are likely to have an in-built affinity for impact investing. So it is not surprising to see many of them in the vanguard of the impact investing movement. Yet there is room for even those leaders to do far more, and for those that have yet to join the movement to do so.

Historically, foundations have mostly expressed their commitment to achieve social good by making grants – notwithstanding the establishment decades ago of the related concepts of programme-related investing (PRI) and mission-related investing (MRI). The development of a broad range of impact investment opportunities has created the option for them to use significant amounts of their investment capital to pursue their social objectives. For example, a 5% allocation of foundation portfolios in the US to impact investment would unleash a pool of capital equal to all their mandated annual grant-giving, whilst generating a financial return and improving their portfolio’s diversification.

Already the *F.B. Heron Foundation* in the US has taken the decision to invest all of its endowment in achieving impact. In the UK, the *Esmée Fairbairn Foundation* has implemented an allocation to impact investment that has already reached 3%. The recent launch of the Taskforce’s US NAB report immediately led to fresh commitments by foundations and wealthy individuals to impact investing of nearly $2 billion.[28]

Foundation trustees, in common with pension funds, in different countries face, or believe they face, a range of cultural and, in some cases, legal impediments to using their assets for impact investment. In the UK, for example, the Law Commission concluded in a recent consultation paper ‘that the law concerning charity trustees’ powers to make social investments is not as certain as it should be, and would benefit from being put on a more solid footing’. It also concluded that ‘the duty of charity trustees when making a social investment is to obtain the best overall return from the investment, and that is not limited to a purely financial return. Instead, it should be based on the combination of the financial benefit from the transaction and the extent to which the transaction achieves the charity’s purposes’. Uncertainty on points such as these currently may be dissuading some trustees from making impact investments.

> “A key recommendation of the Taskforce is to give foundation trustees the freedom to invest in impact assets, and where possible a clear signal that allocating some of an investment portfolio to impact investment is positively desirable.”

In the US, the NAB has recommended that the Internal Revenue Service (IRS) should consider updating its standard for so-called ‘jeopardising investments’ with language used in legislation in some States to allow consideration of ‘an asset’s special relationship or special value, if any, to the charitable purposes of the institution’. South Africa has altered its fiduciary regulations to require that investors ‘consider any factor which may materially affect the sustainable long term performance of the investments including those of an environmental, social and government character’.

Uncertainty in this area is commonplace across the world. Hence a key recommendation of the Taskforce is to give foundation trustees the freedom to invest in impact assets, and where possible a clear signal that allocating some of an investment portfolio to impact investment is positively desirable. In some countries, this may require the introduction of a supplementary statutory power to allow foundation trustees to make impact investments.

Philanthropy has another huge role to play by supporting the development of the impact investment market with grants, including helping develop business models that are attractive to impact investors and reduce the riskiness of impact assets to mainstream investors. For instance, philanthropists have played a crucial role in bearing the early ‘pioneer risk’ involved in developing the profitable business models that have made possible the evolution of microfinance from a small industry entirely dependent on charity into a far bigger one that has become extremely popular with impact investors, some of which have earned good returns whilst significantly increasing access to financial services for poor people.

The Gates Foundation is using its enormous capital endowment to make impact investments and drive financial innovation. When an investment opportunity is expected to deliver less than the foundation’s hurdle rate of return, it can split the amount into an investment component and a related grant, to the extent necessary for the investment to achieve its hurdle rate. In another innovation, the *Bloomberg* and *Rockefeller* foundations have provided first loss guarantees to SIBs in order to ‘crowd in’ other investors. Featuring case studies from Australia, Tanzania, and the US, the GIIN report, *Catalytic First Loss Capital*, documents how foundations and governments have started offering first-loss capital to attract mainstream investors and thereby dramatically increase the funding for specific social solutions.[29]

Philanthropy can also use grants to provide risk reduction insurance for financing terms, such as flexibility on the repayment dates of loans, that can help impact delivery organisations attract impact investment or, indeed, mainstream commercial funding. The *Gates Foundation* has made several interesting moves in this area, such as providing mortgage guarantees to charter schools buying their buildings. In September 2013, with *JP Morgan*, it also helped launch the Global Health Investment Fund, which has raised over $100 million from impact and commercial investors to develop drugs that are in the late stages of testing, as well as new technologies, that can help improve health in the developing world. The *Gates Foundation* has guaranteed to cover losses made by the fund, up to the first 20%, although Bill Gates says he expects it actually to make a good profit while it helps save tens of thousands of lives.

The billionaire US philanthropists who have signed the Giving Pledge, who number over 120 and represent a notable advance in the development of philanthropy in the US, have talked about providing a lead in building up the impact investment market, and have taken some steps to do so. We encourage them to build on this promising beginning by directing a significant part of their wealth into impact assets. Already the *Gates Foundation*, the *Skoll Foundation, Omidyar Network,* the *Case Foundation* and the *Milken Foundation* are vocal proponents of impact investment, while the *Case Foundation* and *Omidyar Network* are leading a study group that aims to create a forum for Giving Pledgers interested in impact investing to learn from the experiences of their peers.

28 “Background on the White House Roundtable on Impact Investing: Executive Actions to Accelerate Impact Investing to Tackle National and Global Challenges”. Available at: www.whitehouse.gov/sites/default/files/microsites/ostp/background_on_wh_rountable_on_impact_investing.pdf

29 GIIN, Issue Brief: Catalytic First Loss Capital, October 2013. Available at: www.thegiin.org/binary-data/RESOURCE/download_file/000/000/552-1.pdf . See also Cabinet Office, Achieving Social Impact at Scale: case studies of seven pioneering co-mingling social investment funds, May 2013. Available at: www.gov.uk/government/publications/achieving-social-impact-at-scale

INCENTIVES FOR IMPACT INVESTORS

The Asset Allocation WG also identified opportunities for governments to encourage more impact investing through setting better incentives, expanding choice and removing regulatory barriers. Though each country will inevitably take account of its own system and political circumstances in deciding which if any of these incentives are needed, or politically feasible, there are important lessons to be learnt from the US's experience of direct federal policy with the New Markets Tax Credits, the Community Reinvestment Act (CRA), and the Low Income Housing Tax Credit (LIHTC), all of which greatly increased the flow of capital to poorer parts of the USA. The New Markets Tax Credits provide a tax incentive for investment in underserved communities. Since 2000, over $31.1 billion in New Market Tax Credit transactions have been reported, creating around 561,873 new jobs, while the CRA has used regulation to channel capital from banks to underserved communities, totalling $55 billion in 2013 alone.[30] The CRA and the LIHTC together represent an annual market of $6-10 billion and maintain solid bipartisan support.

> "Specialist intermediaries are needed to bring together investors seeking impact and the organisations that are capable of delivering it."

In April at Budget 2014, the UK government announced the rates of the Social Investment Tax Relief. Individuals making an eligible investment can deduct 30% of the cost of their investment from their income tax liability and can defer capital gains tax charges under certain conditions. The relief is available to individuals who subscribe for qualifying shares or make qualifying debt investments in social sector organisations that meet the requirements. Investments in SIBs will also be eligible.

> "A report by Bank of America shows that half of their high-net worth clients want to reflect their societal values in their portfolios, and the proportion is higher the lower the age group."

Other governments may wish to consider doing something similar to encourage the impact investment market or to catalyse impact investment by providing matching capital or first loss capital to help attract investors.

IMPACT INVESTMENT INTERMEDIARIES

Intermediation is critical for the development of the impact investment market. Specialist intermediaries are needed to bring together investors seeking impact and the organisations that are capable of delivering it. To help bridge the gap and to forge a distinct culture of social impact investing, there is a need for specialist intermediaries to play at least as big a role as in mainstream finance. They are also needed to build the data and provide the analysis that is critical to attracting investment for both the social sector and impact-driven businesses, and to help bring about the necessary culture change.

The development of specialist impact investment managers and impact investment intermediaries should be a key policy objective. Just as with venture capital and private equity previously, a profession of impact investment managers and advisers needs to be created in order to deploy significant capital. Sizeable investment vehicles will be needed that can assemble significant portfolios of investment opportunities to deliver attractive combinations of financial and social return at acceptable levels of risk. The development of effective intermediaries is also crucial if we are to satisfy growing investor demand.

A new wave of impact investment managers is forming across many countries, including *Bridges Ventures* (UK and USA), *Acumen* (USA), *Citizen Capital* (France), *BonVenture* (Germany) *Double Bottom Line Investors* (US), and *Sustainable Jobs Fund* (USA). The *Social Venture Fund* is the first pan-European fund and the first to receive investment from the European Investment Fund's accelerator programme. They are managing funds investing in impact-driven organisations and searching for investment opportunities in organisations that help underserved communities at home or in emerging markets.

Alongside investment managers, a new set of impact finance intermediaries is developing fast, including *Social Finance* (UK, USA, Israel), *Imprint Capital* (USA), *Third Sector* (USA), *ClearlySo* (UK), *Société d'Investissement France Active* (France) and *Social Ventures Australia* (Australia). The *Institut de Développement de l'Economie Sociale* (IDES) associated with *Credit Coopératif* has 30 years of experience in financing impact-driven businesses through a specific quasi-equity instrument, 'participating equity'. Since 1995, more than 13,500 people have invested over $1 billion in Calvert Foundation's Community Investment Note to support community development and social enterprise in the US and around the world.

In order to build up impact intermediaries, the UK took the initiative in April 2012 of establishing *Big Society Capital* (BSC) as an independent social investment company to act as a significant wholesaler of capital and a champion for developing the impact investment market. BSC's equity capital has been funded with £400 million from unclaimed bank assets and £200 million from the UK's leading retail banks, *Barclays*, *HSBC*, *Lloyds* and *RBS*.

BSC has already played an important role in investing in new and existing impact investment management organisations, and increasing the understanding of impact investment among the relevant actors in the UK. It is starting to help unlock innovation and entrepreneurship in a new generation of organisations and individuals tackling social issues across the UK.

> "BSC has already played an important role in investing in new and existing impact investment management organisations, and increasing the understanding of impact investment among the relevant actors in the UK. It is starting to help unlock innovation and entrepreneurship in a new generation of organisations and individuals tackling social issues across the UK."

Its experience over the past two years is instructive. It has committed £150 million to 31 social impact investment managers and a social bank which together deploy unsecured debt, secured debt and equity, and has attracted an equal amount of matching investment from third parties. In the process, it has helped mainstream investment managers, such as *LGT Venture Philanthropy*, which has set up a joint venture with the *Berenberg Bank* of Germany to manage a £20 million impact venture fund in the UK, and *Threadneedle*, which has created a joint venture with *Big Issue Invest* to manage a cash equivalent impact bond portfolio, the UK Social Bond Fund. It has also supported the UK's first retail social investment offering and Retail Charity Bonds Plc, which will enable charity bonds to be listed on the *London Stock Exchange*. It has worked with government to design tax incentives for investors that extend to social impact funds the longstanding incentives for investors in venture capital trusts (which currently attract several hundred million pounds a year).

Other countries have taken different routes to help create specialist impact intermediaries. In France, savers can choose to put their money into 'fonds d'investissement solidaires dits 90/10 ' (90/10 solidarity investment funds), which allocate at least 90% of the money to traditional mainstream investments and the other 10% or so to funding social enterprises, mostly with long-term loans at low interest rates. The social investment portion of the 90/10 funds mostly flow through three main social investment intermediaries. The creation of BPI France (*Banque publique d'investissement*) may enable it to play a major role in the French context. In the USA, the *Small Business Administration* has launched a $1 billion Impact Investment Initiative.

Meanwhile in Italy a number of initiatives have focused on microcredit, including legislation to create a new microfinance institution supervised by the *Bank of Italy*; a new national body for microcredit; and an extension of government Guarantee Funds to microcredit.[31]

There is potentially a big role for those investment banks and wealth managers that can take advantage of the opportunity to create an impact fund of funds structure. For example, Deutsche Bank which has a long-standing involvement in impact investing in the US and has invested £10 million of its own capital in London in an impact fund of funds and Morgan Stanley is making significant commitments from its wealth management resources to impact investment funds, while J.P. Morgan has committed almost $100 million to Impact Funds. There is great potential to unlock new capital as banks offer impact investing products to their clients on their mainstream wealth management platforms. A report by *Bank of America* shows that half of their high-net worth clients want to reflect their societal values in their portfolios, and the proportion is higher the lower the age group. Several insurance companies are also making allocations to investing in impact funds including *Prudential* (US), *Axa* (France) and *Zurich* (Switzerland).

ENGAGING THE PUBLIC

Habitat et Humanisme is a provider of affordable housing in France. It is one of the biggest beneficiaries of a legal reform in 2008 that required that every employee be given the choice of including impact investments in their pension savings through 'fonds d'investissement solidaires dits 90/10'. Although these funds were available from 2001, with the introduction of the new law in 2008 making their offer compulsory, their assets under management have since grown from €478 million under management to €3.7 billion last year.

30 US Department of the Treasury, 'Treasury Announced $3.5 Billion in New Markets Tax Credit Awards to Revitalize Low Income and Distressed Communities', 5 June 2014.

31 www.bancaditalia.it/vigilanza/normativa/norm_naz/TUB_aprile_2014.pdf; www.microcreditoitalia.org/images/pdf/presentation-enm.pdf

We recommend that all countries consider introducing legislation to make the allocation of some pension savings to impact investment a standard option for everyone.

We also expect to see rapid growth in the use of online crowdfunding platforms to open up impact investing to the general public.[32] So far, sites such as *Kickstarter* and *Indiegogo* have mostly allowed only grant making, whilst *Kiva* has facilitated lending to micro entrepreneurs in developing countries and more recently in the US. But we would expect crowd-sourced equity to grow in importance as and when regulatory barriers are removed. Equity crowdfunding currently constitutes around 4% of the global crowdfunding market which raised $2.7 billion in 2012. *Music Securities* in Japan is an equity-based crowd sourcing platform that now has a $46 million fund, investing in microfinance projects in Asia and South America. So far, several countries have introduced laws regulating equity crowdfunding. Both the EU and US are considering rule changes to make it easier to do equity crowdfunding.

> “As crowdfunding grows, the essentially social nature of fundraising on crowd platforms leads us to expect that a significant part of the money raised will be impact investment.”

As crowdfunding grows, the essentially social nature of fundraising on crowd platforms leads us to expect that a significant part of the money raised will be impact investment. Most systems allow the public to give their money away or to invest it for profit, but many jurisdictions struggle with anything that falls in between, and regulations will have to change to allow crowdfunding of impact investments, as opposed to donations, to take place. For example, in France, regulations have been recently changed to allow the public to invest up to €1,000, per project per person up to a limit of €1 million, in impact investments through crowdfunding platforms. In the UK, a recent report published by the UK Social Investment Research Council has highlighted the steps that could be taken to reform financial promotions regulations, including those that relate to crowdfunding, to ensure that impact-driven organisations and individual investors can participate fully in the impact investing market.[33]

Beyond crowdfunding there is a wider market for retail impact investment through regulated vehicles with established track records, particularly in Europe. *The Global Alliance for Banking on Values* manages impact-based assets of over €100 billion, with over 20 million customers worldwide. There are over 160,000 cooperatives in Europe with 123 million members – many of which are developing impact investments across different sectors. And there are regulated impact investment funds in several countries – for example, the Dutch ‘Groenfonds’, which have deployed over €11 billion from some 234,000 individuals into green infrastructure projects in the Netherlands between 1995 and 2008. *Triodos Bank* has published a discussion paper entitled ‘Impact Investing for Everyone’ for the Taskforce to stimulate policy development in this area. The paper argues that there is a real opportunity to extend the market of professionally managed retail impact investment funds offering expertise and diversification.[34]

CONCLUSION

Many of the barriers to impact investment identified by the Taskforce’s Asset Allocation WG can be removed by enlightened policymaking. The key policy levers that governments can use to facilitate impact investment include regulatory change, fiscal incentives, supplying catalytic capital and building market infrastructure. Use of these policy levers will free up large pools of capital to address pressing social needs. Philanthropic foundations and wealthy individuals can play a pioneering role in catalysing the impact investment market, given their ability to take risks in pursuit of successful social innovation that are often seen as excessive by mainstream investors. Pioneering mainstream investors are also called to play a role in proving that ‘impact investments can sit comfortably within a traditional portfolio framework’.

As capital starts to move into impact investment, and a growing number of organisations pursue both financial and social goals, there will be a huge opportunity for constructive financial innovation. New financial products will be developed. Ambitious people will increasingly turn to impact investing as it becomes one of the flourishing sectors of the financial industry. Like venture capital before it, we expect an increasing supply of impact investment to create its own demand – providing social returns are measured in a reliable way.

32Toniic and European Crowdfunding Network, Crowdfunding for Impact in Europe and USA, 2013. Available at: www.gle.iipcollaborative.org/wp-content/uploads/2014/01/CrowdfundingForImpact.pdf
33 Social Investment Research Council, Marketing social investments - an outline of the UK financial promotion regime, 18 June 2014. Available here: www.cityoflondon.gov.uk/business/economic-research-and-information/research-publications/Pages/marketing-social-investments-outline-of-the-FPO.aspx
34 Available at: www.triodos.com/en/investment-management/impact-investment/

RECOMMENDATIONS

1
Introduce regulatory and tax incentives for impact investment.

2
Define fiduciary duty of foundation and pension fund trustees to allow investment in impact assets.

3
Support specialist intermediaries that manage impact capital and develop impact investment products and services.

4
Make impact products accessible to retail pension and savings investors.

5
Establish a social impact investment wholesaler, potentially financed through unclaimed assets, to serve as market champion and help it create specialist investment intermediaries.

6
Foundations and philanthropists to allocate a percentage of their endowments or wealth to achieving impact.

THE THIRD DIMENSION

The move to a 21st century investment paradigm based on the three dimensions of risk, return and impact depends crucially on the development of reliable measures of social and environmental impact.

One of the key reasons why impact investment has started to grow in recent years is the progress being made in measuring impact in areas where this had previously seemed too difficult. Impact investors are finding ways to inform their decisions by using data such as the grades achieved by children in education, the earnings of small farmers in Africa, the number of people employed in a particular geographical area, how many prisoners have been rehabilitated, the number of unemployed teenagers finding a job or how many drug users have kicked the habit.

The best methods of measuring are now being defined and refined, along with benchmarks for comparison, using control groups, scorecards and randomised trials.

The goal is to develop measures of impact and best practices that are as comprehensive and reliable as those we use for risk and return. Whilst the latter are not flawless, they have proved good enough for market participants to use routinely. In and after the Great Depression of the 1930s, developing measures of economic activity such as GDP and better systems of corporate accounting became a priority for both government and investors, who had come to realise that the lack of reliable measures and consistent practices had contributed to flawed decision making and inappropriate risk taking.

A similar concerted effort is now underway to develop the impact measurement system we need in order to provide a framework for tackling social issues more effectively. It is a task that requires us to overcome significant challenges, but it can be done. Governments are called to play a role in encouraging and supporting efforts to establish the infrastructure and capability required for appropriate measurement in the future.

The effective measurement of impact is important for all social sector organisations in achieving their mission. It is also the key to opening the capital markets for impact-driven businesses. The more that impact measurement makes it possible to link accurately progress in achieving social outcomes to financial returns, the more compelling impact investment will become. Where it is possible to estimate likely social returns and compare the performance of the organisations that deliver them, measurement will help to attract significant capital from a spectrum of investors that seek different combinations of financial and social returns.

A degree of global standard setting in measurement will boost the flow of trade and capital. We are encouraged that several of the EU Directorates-Generals are developing rules for consistent social disclosure as are Singapore and South Africa. The better we get at measuring impact, the more money will flow into impact investment.

MEETING THE CHALLENGE

While it is obvious that not everything that counts can be counted, principles are emerging that allow the measurement of the achievement of many kinds of social outcomes. The growth in impact investors who want these metrics to inform their investment decisions and impact entrepreneurs who want to demonstrate their social impact is driving this change, as is the growing number of governments looking to use pay-for-success contracts and SIBs to finance the achievement of explicit, measurable social outcomes.

Progress has been made on several fronts towards establishing an impact accounting system for companies, through initiatives such as integrated double- and triple-bottom-line accounting, the *Global Reporting Initiative* (GRI), the *Sustainable Accounting Standards Board* (SASB), the GIIN's Impact Reporting and Investment Standards (IRIS) initiative and the EU Standard for Social Impact, which is being developed based on the report developed and endorsed by the European Commission's group of experts on social enterprise.[35] In the UK, the Cabinet Office has supported the launch of 'Inspiring Impact', a ten year sector-led programme aiming to build a coordinated and consistent approach to impact measurement. The growing collaboration between these initiatives, whilst long overdue and still insufficient, combined with the recognition that organisations with similar social missions should agree on common metrics and ensure that metrics should not place an unduly heavy burden on impact delivery organisations, provide real encouragement that there will be further rapid progress.

Another promising effort to create standardised ratings and reporting of impact is the *Global Impact Investing Ratings System* (GIIRS) developed by *B Lab*, the US organisation behind the B Corp certification. The GIIRS rating system uses IRIS metrics in conjunction with additional criteria to come up with an overall company or fund-level rating, as well as targeted sub-ratings in the categories of governance, workers, community, environment, and socially and environmentally-focused business models. There are currently almost 500 GIIRS rated companies in 39 countries, each of which is scored up to a maximum of 200 points on criteria ranging from its commitment to a social mission and its land use to how it treats its workers and the community in which it operates.

As of July 2014, a score of 91 was required to qualify for a 3-star rating, whilst a 5-star rating required at least 125 points.

Among mainstream businesses, while robust measurement of social outcomes (as opposed to essentially marketing-driven reporting of good works) is still unusual, some prominent companies are moving to a sustainable business model, developing detailed reporting around social and environmental issues. For example, *Unilever* launched in 2011 a 'Sustainable Living Plan', pledging by the end of the decade to double its profits whilst halving its environmental footprint, upgrading the skills of people in its supply chain in developing countries and improving the health of 1 billion new customers. In April 2014, it reported that, among other things, 48% of its agricultural raw materials came from sustainable sources, up from 14% in 2010, against a target of 100% by 2020; and that it had helped and trained over 570,000 smallholder farmers and increased the number of Shakti women micro-entrepreneurs in India that it employs from 48,000 in 2012 to 65,000 in 2013. The sooner this kind of measurement is standardised across similar firms and independently audited, the better.

CASE STUDY

La Laiterie du Berger, Senegal

The organisation
As the first company to make dairy products from milk produced locally in Northern Senegal, La Laiterie du Berger (LDB) is both improving the livelihoods of livestock herders and offering nutritional food products to the population at large. Despite the fact that 30% of the Senegalese population are livestock herders 90% of dairy products in Senegal are made from imported powdered milk, which has low nutritional value.

The investor
The company is part of the portfolio of Investisseurs et Partenaires (I&P), *a Paris based impact fund which makes investments in SMEs in Africa. I&P invested in LDB as a start-up and now has a 25% share in the company.*

The Impact Measurement WG highlighted the fund as a best practice example of impact measurement. It works closely with its investees to design specific metrics and systems of reporting on impact recognising the challenges for impact measurement in Africa – notably around data collection (where electronic data management and collection is not an option) and a lack of publicly available data for comparison.

The metrics
For LDB the key metrics are the number of herders, volume of milk collected and the annual income of the herder. If a farmer wants to supply LDB with milk then they are given a churn, each churn being uniquely identified. This enables monitoring of total numbers and volumes as well as enabling calculations to be made about the level of pay at the end of the month. LDB products are now sold in over 6,000 shops. The business is expected to involve over 1,400 herders in 2014 (up from just 200 in 2006), collecting nearly 2,000 tons of milk and increasing the annual income per herder to €408 (up from €314 just three years before). By using these metrics LBD has managed to clearly demonstrate its impact over the past eight years and secured further investment from the likes of impact investors PhiTrust Partenaires *and the* Grameen Crédit Agricole Microfinance Foundation.

35 www.ec.europa.eu/internal_market/social_business/docs/expert-group/social_impact/140605-sub-group-report_en.pdf

EMBEDDING MEASUREMENT

These are some of the buildings blocks on which reliable measures of impact can be built. The report of the Taskforce's Impact Measurement WG, *Measuring Impact*, has developed a vision for an impact measurement convention and a roadmap for its achievement.

Specifically, effective social impact measurement is needed by five key market participants: government, foundations, social sector organisations, impact-driven businesses and impact investors. They all have a broad interest in a wide range of metrics (including the gain to society resulting from a successful intervention, and the associated social rate of return on investment). The importance of other measures will vary from participant to participant (see Chart D). For example, governments will be particularly interested in the fiscal,

"The goal of measurement is to facilitate greater social impact, not to weigh down those trying to deliver it. The best measurement practice will help impact entrepreneurs to run their organisations so as to create greater value in achieving their mission."

economic and social cost of a social issue, as well as the savings accruing to government from a successful intervention. In contrast, investors will be particularly interested in the success rate and cost of interventions, the outcome payments associated with them and the social and financial returns achieved.

As well as accurately capturing impact, it is important that these measures do not impose an undue burden on the organisations expected to generate and use them, so the right balance needs to be reached and no doubt it will take time to achieve it. The goal of measurement is to facilitate greater social impact, not to weigh down those trying to deliver it. The best measurement practice will help impact entrepreneurs to run their organisations so as to create greater value in achieving their mission.

For impact-driven organisations, standardised procedures for issue-based outcomes measurement will soon be in use in many cases where government is the outcome purchaser, as will cost per successful outcome and the economic and non-economic value of a successful outcome for society. Government can help create an enabling environment for measurement standardisation that builds on best practice in the field, as recommended by the Impact Measurement WG.

Investors will need measures of social return which are now being produced, alongside financial performance metrics, as well as indicators of their volatility, to make it possible to identify risk-adjusted financial and social returns, and to get a sense of how the financial returns of different categories of social impact investment are correlated with other types of financial asset.

For foundations as grant-makers, where the financial return from grants is by definition zero, it is important to measure social impact and the cost of achieving that impact at increasing scale in a way that allows the comparison of performance with others pursuing similar goals. Through a comprehensive consultative process with practitioners, the Impact Measurement WG has developed a set of practical guidelines for impact measurement. Among other parameters, this covers goal-setting, reporting, data-driven investment management and validation.[36]

There is concern that smaller organisations may find the cost of measurement hard to bear. Certainly flexibility will be needed to help reduce the effort required from them. There is a strong case to be made for grant support from foundations and/or government to help organisations build up the capacity to measure their impact. Having social impact measurement baked into an organisation's DNA from the start, even if this involves extra upfront cost, is likely to help it be far more effective in the long run in achieving its social mission.

While there may sometimes be a commercial reason not to disclose performance data, we believe there should be a bias towards openness, and an expectation when not disclosing that an organisation should explain why not. We are encouraged that, for example, leading impact investors are starting to share their approaches to impact measurement on the IRIS Registry.[37] Additionally, over 5,000 organisations recognise the potential of their data to inform the industry and anonymously contribute IRIS data to the GIIN to help create a base of knowledge about impact performance.

36 See Table in report of the Impact Measurement Working Group
37 www.iris.thegiin.org/users

CHART D:

CAPTURING IMPACT – KEY DATA NEEDS OF MARKET PARTICIPANTS

	Government (as outcome payer)	**Foundations** (as grant makers)	**Social Sector Organisations**	**Impact-driven businesses**	**Impact Investors**
Cost of an issue to the country					
Fiscal	●		●		
Economic	●	●	●	●	●
Social	●	●	●	●	●
Intervention metrics					
Government savings from a successful intervention	●		●		
Cost of a successful govenent intervention	●				
Social improvement from a successful intervention	●	●	●	●	●
Success rate of outside interventions	●	●	●	●	●
Outside cost per successful intervention	●	●	●	●	●
Investor metrics					
Outcome objectives for beneficiaries	●	●	●	●	●
Performance in meeting objectives	●	●	●	●	●
Performance metrics and benchmarks	●	●	●		●
Outcome payments	●	●	●		●
Social return on investment	●	●	●	●	●
Financial return on investment	●	●	●	●	●

It is also important that organisations be transparent about their overall social impact and not just one aspect of it in isolation. An organisation doing good things with one hand whilst doing far worse things with the other should not be able to use narrow data on its good activities without being transparent about the negative social impact it creates.

> “Impact measurement has already started to shift the paradigm for investment decision-making beyond the established 20th century dimensions of risk and return. It is enabling impact to bring a third dimension.”

In order for the impact investing field to move towards a strong future impact measurement convention, the Impact Measurement WG has identified four priorities for the road ahead: embrace impact accountability as a common value; apply the seven best practice guidelines that the WG has identified; establish a common language and data infrastructure and help the field to maximize the utility of measurement approaches.

CONCLUSION

The WG has established that effective impact measurement would generate value for all stakeholders, mobilise increasing capital flows and improve market transparency and accountability.

Setting clear impact objectives and focusing intensely on achieving them will help impact-driven organisations and investors to deliver greatly enhanced outcomes.

Impact measurement has already started to shift the paradigm for investment decision-making beyond the established 20th century dimensions of risk and return. It is enabling impact to bring a third dimension.

RECOMMENDATIONS

1

Support a single impact accounting system that incorporates existing initiatives by GRI, SASB, GIIN, the EU and GIIRS.

2

Publish data on the costs to government of social issues.

3

Support standardised measurement of social impact to appear alongside financial performance metrics.

4

Foundations to use grant capital to help impact-driven organisations build up the capacity to measure impact.

5

Government adoption of impact measurement in reporting and contracting requirements.

A NEW FORCE IN INTERNATIONAL DEVELOPMENT

Developing countries are not the main focus of this report, but it is clear to the Taskforce that impact investment has the potential to be at least as important for them as it will be for any other countries.

Impact investment approaches have already played an important role alongside the existing flows to developing countries of foreign direct investment, government and multilateral aid, investments and private philanthropy. It has the potential to play an expanded role with a new set of tools to tackle the more complex global challenges faced by developing countries. And impact investing also has the potential to influence other flows of capital in developing economies to work together to the greatest effect, to be an important part of the solution to the challenge of delivering more inclusive economic growth that benefits everyone, in developing countries.

For instance, while generating jobs and higher incomes in developing countries is a “place-based” impact investment, introducing explicit, measurable impact goals can help the achievement of social outcomes that go beyond providing jobs.

Economic growth must go hand-in-glove with the rapid expansion of basic services including health care, education, water and sanitation. Once the world debates and agrees new sustainable development goals to succeed the Millennium Development goals after 2015, impact investment can play a crucial role in financing the delivery of those goals. This includes investments for new types of businesses, social sector organisations and new business models, as well as for DIBs to tackle some of the seemingly intractable social issues that constrain economic growth, such as providing decent education and health care, and improving employment readiness.

THE CHANGING LANDSCAPE

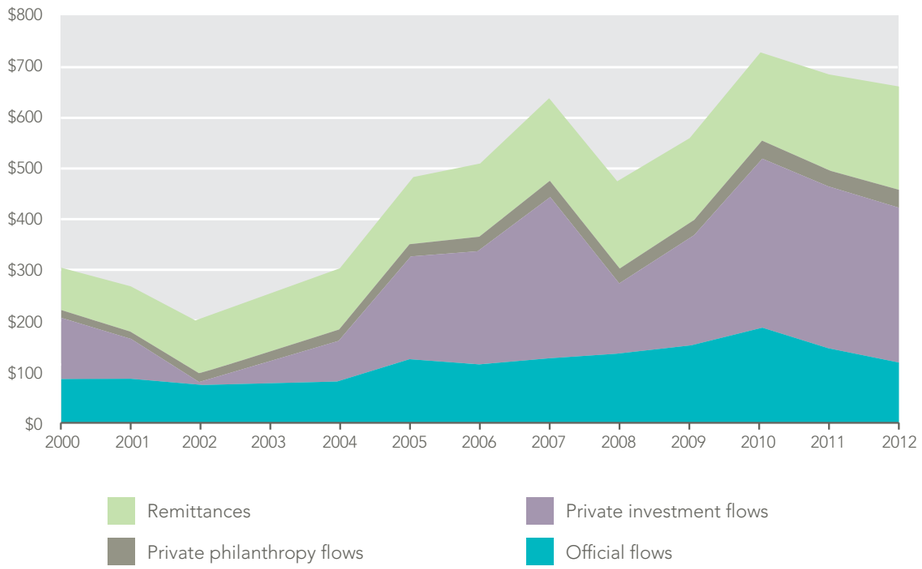
In recent years, even as government overseas aid has continued to make a big contribution to development, there has also been a much-needed conversation about how to make it more effective. International agencies have increasingly looked to use more evidence-based policies and “market-based solutions” alongside other policy tools, and sought new investment models and better ways to partner with the private sector, at a time of increasing private capital flows to developing countries from abroad, from philanthropic sources, investors and diasporas (see chart E).

“Remittances” to developing countries from members of their diaspora working abroad have grown rapidly. Currently, this money is being put to a range of uses, from funding consumption by those receiving the money, to charity and business investment. There is potential for remittances to be deployed as impact investment. Members of a country’s diaspora can, and should, play a leading role in demonstrating how money from abroad can help deliver inclusive growth.

Market trends show that pent-up demand exists among the world’s poorest people for products and services, and that new approaches are emerging for the provision of public and financial services. These factors create demand for impact investing, and it is estimated that 70% of impact investments today are made in emerging markets. Impact investing in international development may turn out to be one of the fastest growing segments of a global impact investment market.

CHART E:

TOTAL FINANCE TO DEVELOPING COUNTRIES BY FLOW TYPE ($ BILLION)



Source: www.cgdev.org/doc/Working%20Groups/DIB%20Working%20Group%20Meeting%201.pdf

THE POTENTIAL

Dealing with global development challenges requires more than money. New approaches and new partnerships between different actors and sources of capital are essential, too.

Impact investments can deliver results for international development. It can transform development finance, because it better aligns all the different sources of capital and expertise, to achieve common development objectives. It brings the expertise of different players to bear on solving complex development challenges and demonstrates how investment and grants can work hand in hand to generate both financial and social returns.

Much progress has been made already. There are a number of multilateral and bilateral agencies committed to the use of private sector capital and innovation to end poverty and boost prosperity in developing countries. For example, *Department for International Development* (DfID) in the UK, *KfW* in Germany, *USAID* in the US, the Multilateral Investment Fund at the *Inter-American Development Bank* and many others have all used both grant and investment capital to achieve development goals for more than half a century.

Funds have also played an important role in the creation and growth of enterprises. For instance, impact investment funds such as *Acumen*, based in New York, use philanthropic dollars to make low profit investments in small and medium enterprises serving customers at the bottom of the pyramid in developing countries. While for profit funds like *Ignia*, a Mexican impact fund (with investors such as Pierre Omidyar) which invests in firms, such as *Mexvi*, which builds extra rooms on homes to reduce overcrowding, and *Ver de Verdad*, which provides affordable, high quality eye glasses to poor households.

Financial inclusion funds have been particularly active and successful. For example, fund managers such as *Bamboo Finance, ResponsAbility* and *Leapfrog Investments* have generated significant social impact and financial returns by investing in the evolution of microfinance from a charitable to a profit-with-purpose activity.

Innovative partnerships between development agencies, large multinationals and local companies are emerging. In one notable example, seed funding from the UK's DFID to *Vodafone* helped them pilot what was to become *M-PESA*, the pioneering mobile phone-based money transfer system of Kenyan telecom operator *Safaricom*. Today the service handles upward of 300 transactions per second and enables over 19 million people who previously had limited access to a bank account to send and receive money, to take out and pay back loans, to buy from street sellers, make bill payments and even pay school fees.

Effective partnerships include France's development agency *Agence Française de Développement* (AFD) and *Grameen Danone*. This social business joint venture, which benefits from a loan guarantee from AFD to Grameen Danone, sells enriched yoghurt products to lower income groups in Bangladesh, while purchasing milk from impoverished herdsmen. The *Japanese International Cooperation Agency* (JICA) offers financial support for projects in partnership with the private sector that tackle a range of problems including access to health care, agricultural development, energy and education. To date, it has provided $40 million to help support more than 80 projects across Asia and Africa.

International agencies have invested in impact and some are exploring the possibility of doing more. Initiatives of Taskforce countries include:

- In 2009 the French government launched a €250 million investment fund managed by *CDC Group Proparco*, the investment arm of the AFD. This Fund, the FISEA (Fond d'investissement pour le soutien aux enterprises en Afrique), makes equity investments in entreprises that have a high development impact in Africa through, for example, creating decent jobs and encouraging sustainable growth.
- In 2010, the Canadian Government created Grand Challenges Canada, which makes impact investments in low and middle income countries.
- In 2011, the German Development Bank *KfW* provided €5 million of investment to the Aavishkaar India Impact Fund. They have invested in to other impact-driven funds like the *MiFA Debt Fund* (which focuses on mobilising refinance for microfinance in Asia), the European Funds for Southeast Europe and the Global Climate Partnership Fund.
- In 2012 the UK's *DFID*, launched the £75 million DFID Impact Fund, managed by *CDC Group*, the UK Government's Development Finance Institution (DFI). In 2014, this fund made its first investment into *Novastar Ventures*, a venture capital fund focused on developing breakthrough businesses that can transform consumer markets at the base of the pyramid in East Africa. These businesses aim to provide low-income households with access to affordable goods and services such as healthcare, agricultural services, energy, housing, education and safe water.
- Also in 2012, the US government's development finance institution, *Overseas Private Investment Corporation* (OPIC), approved up to $285 million in financing for six new impact investment funds.
- In 2013, *DFID* and the US international development agency *(USAID)* announced the joint creation of *Global Development Innovation Ventures* (GDIV), an investment platform they are jointly developing which seeks to foster innovative solutions to the world's hitherto most intractable development challenges.
- Finally, in 2014 Italy approved a law on international cooperation to allow for funding based on public-private-partnerships, making it easier to implement impact investment.[38]

At this early stage of development, improved coordination and strengthened collaboration in the area of impact investment by DFIs and their private sector agencies would do much to help increase capital flows to the social sector. In particular, shared efforts at issuing pay-for-success securities such as DIBs and SIBs, impact evaluation, and co-financing could accelerate the application of outcome-based impact approaches.

Private philanthropic foundations, such as the *Gates Foundation*, have become a crucial source of finance and innovation in addressing development challenges such as reducing death by infectious disease, and helping small farmers escape poverty by improving agricultural supply chains. They have played a leading role in pioneering efforts to harness the power of private capital to do good. One such example, akin to the role of a domestic outcomes purchaser, is the "advance market commitments" that provide an incentive to companies to invest in order to innovate by guaranteeing to them advance purchase of essential drugs or vaccines once they have been developed. The first of these, launched by the foundation in partnership with the governments of Canada, Italy, Norway, Italy and the UK in 2007, committed $1.5 billion to buy a new vaccine against pneumococcal disease with the potential to save the lives of seven million children by 2030.

38 www.cooperazioneallosviluppo.esteri.it/pdgcs/Documentazione/NormativaItaliana/legge%2011%20agosto%202014%20n.%20125%20-.pdf

OUR PROPOSALS

To help impact investment fulfil its potential in developing countries, the Taskforce's International Development WG has set out several proposals for government, business and the social sector, both in developing countries and for their counterparts abroad who are trying to help in their development. These proposals cover areas that the rest of this report addresses for Taskforce member countries, namely: boosting impact entrepreneurship; encouraging the spread of financial and non-financial tools for impact investment including SIBs and DIBs; and measuring impact.

Boosting Impact Entrepreneurship

Although capital flows to the developing world are growing, especially flows into infrastructure projects, far too little capital is reaching small and medium-sized businesses, impact entrepreneurs and inclusive businesses.[39] Impact funds that have focused on developing economies have been far smaller than some of the mainstream funds focused on the same countries because they invest in businesses that mainstream investors regard as too risky. Impact investors that value social impact can be of major help in taking on the "pioneering risk".

> "Our proposals cover boosting impact entrepreneurship to help achieve scale; encouraging the growth of instruments for impact investment; and measuring impact."

To this end, in its Subject Paper, the International Development WG, composed of development impact practitioners, recommends exploring ways of identifying and supporting local investors and developing impact funds. This includes exploring the possibility of creating a new, significantly sized, early-stage Impact Finance Facility. While the details are still to be fully worked out, the idea is a wholesale facility, operating as a fund of funds and managed by a private fund manager. The purpose of the facility would include identifying and supporting local impact investors; encouraging innovation in fund structures; support to early stage firms; and offering finance facilities that help provide guarantees and improve the risk-return ratio for commercial investors.

Its main characteristics would include linking capital to technical support on one hand and the flexibility to make a full spectrum of investments, including equity, debt and SIBs and DIBs on the other. It would encourage local talent to find solutions to pressing development challenges, and would reward innovative approaches. Enterprises based in frontier markets could apply via a competitive process, and support would include a combination of grant financing, to build up technical capacity and provide working capital, and investment that is tailored to the particular needs of the business. The WG urges consideration of the development and design of such a facility.

SIBs and DIBs

The International Development WG also encourages developing country governments to explore where SIBs and DIBs might contribute to increasing the effectiveness of government service delivery, funding innovative approaches to delivering specific social outcomes and tackling social issues that constrain economic growth. SIBs/DIBs are a new model for public private partnerships that attract private investment and align incentives towards achieving social outcomes. The DIB is an innovative idea that has much in common with the SIB, but with the crucial difference that bilateral aid agencies, foreign aid ministries, multilateral institutions and philanthropists pay for the outcomes delivered instead of the local government. DIBs are still in their infancy. The first was announced in June 2014 by the *Children's Investment Fund Foundation* and UBS's Optimus Foundation to improve the quality of girls' primary education in Rajasthan, India. Also in the works are DIBs seeking to reduce the incidence of sleeping sickness in Uganda (by lowering the rate of infected cattle, which tend to carry the disease), to reduce incidence of malaria in Mozambique, and to improve early childhood education in Rwanda.

DIBs have the potential to transform the way that social services are delivered by bringing the public and private sectors together to solve specific social problems. DIBs could attract finance for the achievement of goals targeted in the United Nations framework beyond 2015. In the appropriate context, DIBs could help countries to reach these goals because they bring a rigorous focus on results that is lacking in input-based development programs. The fact that they make significant capital available without specifying inputs creates a space for service providers to innovate. The data they generate creates valuable feedback loops that help inform policy decisions about social services and identify interventions that deserve extension.

The International Development WG has also recommended the establishment of a DIBs Social Outcomes Fund to pay for successful DIB-funded interventions. This would create an opportunity for a number of actors interested in DIBs to spread the risk and share the lessons from DIB pilots in different sectors and countries. It would help catalyse the market by facilitating the provision of outcomes funding, which is a significant challenge in developing countries.

> "This is a world first for international education… Development Impact Bonds will focus governments and the aid industry on costing and paying for results. This model can transform the way development is done: new ways of working, and a clear accountability around outcomes for children. We want to test this model, and we want to show the world it can work."

Michael Anderson, CEO Children's Investment Fund Foundation about the Rajasthan DIB

Measurement

The development of good measurement systems to underpin impact investing is as important in the developing world as it is in Taskforce countries. That said, it is important to acknowledge that the operating context in developing countries is more challenging in terms of the data available and the capacity for planning and monitoring. DIBs, in particular, depend on accurate measurement of outcomes, so if the market for DIBs is to take off, it is crucial that governments put in place the necessary measurement and reporting systems. Recognising that there may be a lack of accurate government data on social issues and limited capacity for data collection in some countries, we believe that development finance institutions could help develop systems on the lines set out in the Impact Measurement WG's Subject Paper.

The rapid spread of mobile phones in developing countries has the potential to generate and relay much valuable data, for use by impact-driven organisations serving those at the bottom of the pyramid. Micro-lenders are already making use of mobile data to inform their decisions on credit-worthiness by relying on only a handful of data points generated by the phone.

CONCLUSION

It is clear to us that there is much more that impact investment can do for development. We see an important role for international finance institutions such as the World Bank. We are encouraged by the example of OPIC, which in 2012 started to examine its investments against an impact "intentionality test". By putting more impact data into the public domain, development agencies are helping to provide better insights for potential impact investors, entrepreneurs and governments.

The International Development WG believes that impact investing has considerable potential to help developing countries. Testing and scaling impact investing approaches to tackle challenging social issues that constrain private sector development and economic growth should be an urgent priority.

39 www.g20challenge.com/what-is-inclusive-business

RECOMMENDATIONS

1
Support coordination and collaboration between DFIs and their private sector agencies to advance impact investment.

2
Explore impact funds to support small and medium-sized firms and those serving bottom of the pyramid customers.

3
Allow development finance institutions to increase impact investment efforts.

4
Explore creation of a Impact Finance Facility to provide early-stage risk capital.

5
Encourage governments to explore how SIBs and DIBs might contribute to efficiency of social service delivery.

6
Explore creation of a DIB Social Outcomes Fund to pay for successful DIBs.

GALVANISING A GLOBAL IMPACT MOVEMENT

As the Pope said at a Vatican conference on impact investing in June 2014, "it is urgent that governments throughout the world commit themselves to developing an international framework capable of promoting a market of high impact investments, and thus to combating an economy which excludes and discards."

And as former US Treasury Secretary Lawrence Summers said a month earlier, after investing in one of the US's first SIBs, "This is ground zero of a big deal."

Nothing less than a revolution is needed to improve the lives of millions who are being left behind. Philanthropy first took up the challenge in an organised way in the 19th century, then in the 20th century governments joined in; now the spiralling magnitude of social issues demands that government, philanthropy, the social sector and business all work together. If we fail to do so, those left behind as our economies progress may be left permanently behind, and the equality of opportunity that has been our mantra for several decades will prove to be meaningless for those born into disadvantage.

The forces of entrepreneurship and innovation, which have transformed the way we live, can now be harnessed to transform the way we tackle social issues.

All of the countries that formed this Taskforce face major challenges in tackling social issues such as poverty, unemployment, chronic ill health, criminal justice, dysfunctional childhood and an ageing population and social issues arising from climate change. If the recommendations set out in this report are implemented and we succeed in developing a thriving global market in impact investment, then vast quantities of capital will be mobilised to invest in the rapidly expanding global efforts of impact-driven organisations.

What is needed now is bold, enlightened leadership to implement our recommendations and catalyse a dynamic global social impact investment movement. Its leadership must come from many different groups including foundations, social sector organisations and businesses, impact entrepreneurs and investors, national governments and global organisations. Bottom-up, grass roots leadership will also be needed from the public to demand change, both as citizens wanting solutions to society's problems and as investors who want their savings to be invested in ways that help build the world they want for their children and grandchildren.

While the impact investment market is already gathering momentum, without government leadership its development will be slow and its impact more limited. There is real activity and investor and entrepreneur interest in this market, but government leadership is needed to remove barriers, build capacity, catalyse investment activity and harness the power of the market to address critical public policy challenges. Our high-priority recommendations to leaders in different parts of society start with government. Implementation is a matter of urgency.

Over the past 40 years, governments have played an important role in supporting business entrepreneurship and technological innovation. They have done so by adjusting regulation, providing tax incentives, and using grants of various kinds; by recognising successful entrepreneurs and celebrating the organisations they lead; and by favouring the establishment of an effective venture capital sector and specialised stock exchanges capable of providing risk in

helping to build valuable, innovative companies. To empower ambitious impact-driven organisations and entrepreneurs to achieve real impact on social issues, governments now need to play a similar role in supporting impact investment.

We have several urgent recommendations for national governments. First, a champion is needed for impact investment within and beyond government. Ideally, this person will be a senior government minister empowered to act as a leading champion for impact investment, helping to formulate and implement appropriate policies that build market infrastructure and to support the development of the sector.

Governments should also form a clear assessment of the social impact investment ecosystem at the national level, in order to identify and pursue

“Over the past 40 years, governments have played an important role in supporting business entrepreneurship and technological innovation. To empower ambitious impact-driven organisations and entrepreneurs to achieve real impact on social issues, governments now need to play a similar role in supporting impact investment.”

opportunities to make it more effective. Equally important is identifying the social policy areas where impact investment can have greatest leverage in each country, and setting out policies to equip social sector organisations and innovators to access the impact investment market, including providing grants to social sector organisations for capacity building. This will involve creating supportive legal and regulatory frameworks, in the case of social sector organisations to ensure that the rules governing them do not inhibit entrepreneurial risk-taking and innovation, and for impact-driven businesses, to ensure that they can, if they want, maintain their social mission, through legal mechanisms and forms; removing regulatory obstacles around fiduciary duty that currently deter potential impact investors, and, where possible, providing tax incentives.

Government can also play a leading role as a purchaser of outcomes in its own right, either centrally or at the level of local authorities. Within federal systems, the role of states and municipalities is particularly important. Creating outcome funds that can be competed for by central government departments or local authorities; publishing data about social issues, such as the existing cost to government of addressing them; and supporting the development of impact measurement standards by adopting them in its own reporting and contracting are all initiatives that can help build a thriving impact investment market.

The European Union has a major role to play. We are encouraged by its significant efforts to support social investment and innovation, such as the Social Business Initiative, the creation of European Social Entrepreneurship Funds (EuSEF) and the work on social impact measurement by the GECES's experts group. The EU's European Social Fund alone is directing €10 billion a year to improving job prospects for the unemployed, especially those from disadvantaged groups, so its power to help establish impact investing in Europe is considerable.[40]

Inter-governmental institutions such as the *World Bank, IFC* and regional development banks are also called to play a pioneering role, not least as issuers of and investors in a new market for DIBs.

After governments, foundations and the charitable trusts of wealthy individual philanthropists have the opportunity to be the most active force in the development of the impact investment market. This will require the courage to challenge cultural norms in the philanthropic sector, including how endowments are invested, and the willingness to embrace the risk involved in backing innovative new ideas that can improve society.

Specifically, we recommend allocating part of every charitable endowment and high net worth investment portfolio to impact-driven investments, and that foundations should look for opportunities to encourage mainstream investors to engage in impact investment by providing some investment protection through first-loss guarantees. And philanthropy has another important role to play in making grants to build the capacity of impact providers, impact investment managers, and impact finance intermediaries, and to support initiatives to develop reliable measures of impact.

The impact investment market represents a huge opportunity for mainstream investors, including pension funds, sovereign wealth funds and independent investment managers. Impact investment is not charity, but an opportunity to earn a financial as well as a social return, doing good and well while gaining the benefits of

40 www.ec.europa.eu/esf/main.jsp?catId=35&langId=en

improved diversification. Whilst in some cases, legislative change will be needed first to clarify that impact investment is permitted under the existing rules of fiduciary responsibility, we believe that the extent of the legal barriers to impact investing is often exaggerated within the investment world, and that leadership within the investment industry can bring a change in culture, sufficient to unleash significant flows of capital.

An increase in impact investment flows has the potential to allow leaders of existing social sector organisations, as well as social sector start-up impact entrepreneurs, to increase their impact by raising additional capital to finance the scale up of their innovative ideas. They are likely to grasp this opportunity with both hands, setting out to build organisations able to access the impact investment market, because they set clear social objectives and measure progress towards them.

“The impact investment market represents a huge opportunity for mainstream investors, including pension funds, sovereign wealth funds and independent investment managers. Impact investment is not charity, but an opportunity to earn a financial as well as a social return, doing good and well while gaining the benefits of improved diversification.”

Where a for-profit business model offers the best path to large scale impact, investors wishing to lock- in the social impact mission of their investees can encourage them to become a profit-with-purpose company, for example by using a benefit corporation-like structure or by issuing a golden share that can prevent mission-drift. Where investors wish to invest in impact-driven, regular businesses, they can encourage them to pursue specific measurable social impact and track their progress in achieving it.

As impact investment flows increase, social sector organisations and businesses alike will get used to measuring their social impact and to disclosing it.

In the effort to catalyse a global market in impact investment, international governmental organisations can play a valuable leadership role using their convening power to champion social impact investment, and providing a forum for the sharing of best practice. The establishment of this Taskforce during the UK's presidency of the G8 is an important example. Inter-governmental bodies, including the G20, ASEAN, APEC OAS, and the African Union, should consider putting on their agendas the development of social impact investment.

Inter-governmental organisations such as the *Organisation for Economic Co-operation and Development* (OECD) and others can play an important role in putting social impact investment on the international policy agenda as well as engaging other stakeholders. To complement the Taskforce's report, the OECD is preparing a report on the social investment market which aims to lay the groundwork for data collection, analysis and policy discussions on a global basis. The report, which builds on earlier work on this and related topics, will be published later this year.

As the United Nations resets its Millennium Development Goals in 2015, we recommend that it considers supporting impact investment as an innovative way of tackling the social and environmental issues that constrain private sector development and economic growth: tackling issues in education such as literacy and drop-out rates; in health such as sleeping sickness, malaria and other chronic debilitating diseases; and in employment such as training unemployed youth for available jobs.

Non- government bodies have been at the forefront of the development of impact investing and impact entrepreneurship, including *Ashoka,* the *Clinton Global Initiative,* the *Skoll World Forum* and, not least by publishing several influential reports, the *World Economic Forum.* They should continue to show leadership by shining a spotlight on impact investment and providing a forum for innovators in the field. We also look to organisations such as the OECD, the GIIN and the B-team to support the development of impact investing by publishing market surveys, analysing social issues, mapping impact entrepreneurs globally, certifying purpose-driven corporations and campaigning for policy and culture change.

AN IDEA WHOSE TIME HAS COME

We all have a vital leadership role to play in catalysing the market for impact investment, through how we invest and how we participate in helping to create impact. We can demand impact investment products from the institutions managing our savings. We can find out if our

pension fund providers have signed the UN Principles of Responsible Investment, or any other pledge to take seriously the social and environmental impact of their investments, and urge them to take those obligations seriously. We can urge them to engage in impact investment. As citizens, we can demand that our governments implement policies to support impact investment.

The paradigm is shifting. Together we can bring a revolution to improve lives. We can seize the opportunity to tackle social and environmental issues in new and more powerful ways. We can do so by setting measurable outcome objectives for social sector and for-profit organisations alike and by measuring their progress in achieving them; by attracting talented, ambitious and innovative people to build impact-driven organisations that do good as they do well; and by putting social sector organisations in a position to compete with businesses for managerial talent and capital in driving social innovation, scale and impact.

Governments need innovation in delivering social services and they need to attract the risk capital to finance it. They can drive innovation domestically and in developing countries not least by committing to pay for successful outcomes. The organisations they commission will create new sets of investment opportunities that blend social, environmental and financial returns while improving investment portfolio diversification. Regular businesses, large and small, will become increasingly aware of their social impact, setting social, environmental and financial objectives and measuring progress towards achieving them.

This is the revolution that impact investment portends. Across the world, we can harness entrepreneurship, innovation, capital and the power of markets to do good. If we achieve our goal, in future the invisible heart of markets will guide the invisible hand to improve the lives of those who would otherwise be left behind.

SUMMARY OBJECTIVES AND RECOMMENDATIONS FOR POLICYMAKERS

This Taskforce has made a number of important recommendations to all those involved in social impact investment.

This section provides a summary of the objectives and recommendations for governments in developing the ecosystems which are crucial to the development of impact investment as a powerful force. Further detail can be found in the Explanatory Note on Policy Levers and Objectives.

Recognising there is no 'one size fits all' approach, policy makers need to consider their own context and the policy opportunities that suit their particular environment, their policy priorities and the existing nature of social service provision.

In all cases, however, government has the opportunity to stimulate greater innovation in the delivery of services and achieve 'better impact for money'. To ensure social impact investment thrives, government has an important role to play, as a **market builder**, as a **purchaser of social outcomes** and as a **market steward**, removing barriers and ensuring that the positive intentions of impact organisations are safeguarded over time.

In all three of its roles, government is called to make a number of policy decisions.

MARKET BUILDER

Objective: Increased resources and support for impact-driven organisations to strengthen their operations and grow:

- *Provide capability-building grants for impact-driven organisations.*
- *Improve access of impact entrepreneurs to capital, including seed, early-stage and growth capital.*
- *Expand existing SME business support to impact-driven organisations.*

Objective: Increased flow of talent to the sector to build and grow impact-driven organisations:

- *Encourage existing impact-driven entrepreneurs and new entrants by celebrating success in the sector and offering rewards for innovation.*
- *Consider tax incentives for impact-driven organisations and entrepreneurs.*

Objective: A developed impact investment culture, with a range of intermediaries that manage impact capital and provide professional advice and services to the impact investment sector:

- *Create a social investment wholesaler to act as a market champion, potentially financed by unclaimed assets in bank accounts, insurance companies and pension funds.*
- *Consider early-stage support to specialist impact investment funds, intermediaries and advisory firms.*
- *Support efforts to establish a 'kitemark' or labelling system that identifies social finance products for particular segments of the market.*
- *Support efforts to enable access to a social stock exchange.*
- *Promote the use and development of innovative impact finance products.*

Objective: New investors entering the social impact investment market:

- *Provide tax incentives for impact investors.*
- *Provide regulatory incentives for impact investment.*
- *Examine specifically what can be done to bring social impact investment to the mass retail market.*

MARKET PARTICIPANT

Objective: Increased effectiveness of government's role as an effective purchaser of social outcomes:

- *Broaden use of outcomes-based government commissioning.*
- *Create consolidated domestic outcomes funds, for use by government departments that are unable to recognise the full value of social outcomes they achieve.*

Objective: Increased flow of investment from mainstream investors to impact-driven organisations:

- *Provide matching finance to pump-prime the impact investment market, where it is emergent – or provide first loss facilities and other guarantees, and capitalise a social investment wholesaler or impact investment funds.*

MARKET STEWARD

Objective: An appropriate regulatory and legal framework for impact-driven organisations:

- *Create legal forms or regulations that protect the social mission of impact-driven businesses.*
- *Relax regulations that prevent social sector organisations from generating revenues.*

Objective: Fewer legal and regulatory barriers in the way of potential impact investors:

- *Encourage pension funds and providers of other tax-advantaged savings schemes and products to include impact investment options as part of their offering.*
- *Reduce the restrictions on retail investors engaging in impact investing e.g. through crowdfunding and other measures.*
- *Define fiduciary duty of foundation and pension fund trustees to allow investment in impact assets.*
- *Investigate how impact investments can be integrated into existing regulatory frameworks covering banks, insurance companies and investment funds.*

APPENDIX I

The Taskforce gratefully remembers the contribution and efforts of Ted Anderson, Canadian sector representative, and Stephen Lloyd, member of the Mission Alignment Working Group, who both sadly passed away during the course of our work. The contribution they made to the content of our reports is part of their important legacy to a field that mattered greatly to them both.

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APPENDIX II

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Social Stock Exchange
The Cabinet Office
The Mansion House
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EXPLANATORY NOTE FOR GOVERNMENTS ON POLICY LEVERS AND OBJECTIVES

WORKING GROUP SUBJECT PAPERS

Measuring Impact
Subject Paper of the Impact Measurement Working Group

Allocating for Impact
Subject Paper of the Asset Allocation Working Group

Profit-with-Purpose Businesses
Subject Paper of the Mission Alignment Working Group

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Report of the Canadian National Advisory Board

Report of the French National Advisory Board

Report of the German National Advisory Board

Report of the Italian National Advisory Board

Report of the Japanese National Advisory Board

Report of the UK National Advisory Board

Report of the US National Advisory Board

“The financial crash of 2008 highlighted the need for a renewed effort to ensure that finance helps build a healthy society. This requires a paradigm shift in capital market thinking, from two-dimensions to three. By bringing a third dimension, impact, to the 20th century capital market dimensions of risk and return, impact investing has the potential to transform our ability to build a better society for all.”