Increasing Interest in Impact-Oriented Investment

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The article describes the societal change driving the change to impact investment and discusses where the funds are coming from. As Alison Hope articulates a role for philanthropy in her article, so does Rodney Swartz see a significant role for philanthropic grants and expert support Of note Social Enterprise UK and the Big Lottery Fund have just published a useful guide (Social Investment Explained) to advise charities on how to get investment ready. However, it is important to note the Guide does narrowly define social investment to achieving financial returns of some sort in addition to a social return, thus leaving out other forms of social investment such as venture philanthropy and other forms of philanthropy investing for an impact.

Rodney Schwartz

As we emerge from the crisis, there has been an increasing interest in impact-oriented investment. We have noticed this from high-net-worth individuals in particular, who are more and more frequently considering social impact investment as part of their strategy for philanthropy, and indeed as part of their strategy for making financial returns on their portfolio.

This growth prompts two important questions. The first is around what is actually driving this trend and the second is about where this money is coming from for those for individual investors.

So why is this happening? Yes, the financial sector is being held to account for its impact much more, but the change in the financial sector is matched by a change in consumer attitudes too, and there is increasing evidence that the drastic public sector funding cutbacks have dramatically raised public consciousness about some of our social problems.

The first 25 years of my career were largely in finance and there isn't a single colleague with whom I speak who does not now accept on some level that "yes, perhaps we push things a bit too far?" – and that as a result there are serious problems that need addressing. Yet this increasing awareness is not just something that has appeared over the last few years. We can see from the growth in fair trade food products, for example, that the public's willingness to use its purchasing power to pursue ethical preferences has been prevalent for some time. There are other examples, such as the growth in Marine Stewardship Council, or the Who Made Your Clothes campaign that sprung up after the Rana Plaza disaster last year. This expression of ethical preferences has entered the world of consumption and is seeping into the world of finance.

Over the past few years, there has been a dramatic shift underway in the world's financial markets. Prior to 2008 – and for at least three decades – investing has been dominated by a two-dimensional approach. In this world, investors sought to maximise risk-adjusted rates of return on capital; the two dimensions at play were risk or volatility and financial return. What appears to be the case is that we have entered the world of 3-D investing; a growing number of individual and institutional investors are starting to make conscious trade-offs between risk-adjusted rates of return on the one hand and social impact on the other.

The social, ethical and environmental benefits that are engendered by these investments are being consciously assessed and sometimes traded off against risk-adjusted rates of return. A good example of this is the Ethical Property Company, which has been issuing shares for the past decade or more - it rents out office space to social change organisations and runs its business in a highly socially and environmentally sustainable fashion. The shareholders who support this company value the positive social impact of EPC and are prepared to accept lower rates of return in order to achieve this. Indeed, in marketing documents, the company makes it very clear that investors will not get a market rate of return on the investments.

So we know the trend is there, and that it is growing – but where does this money actually come from?

The answer here is complex. We are regularly asked for straightforward answers about whether, for individual investors, this comes out of the 'philanthropy pot' or the 'investment pot' – and the answer is 'both'.

Many individuals we speak to are becoming increasingly aware of one feature of impact investment – that these deals are structured in a way that investors will normally get their capital back at the very least. For generous philanthropists who are attentive to the degree of social impact they receive, there is a growing awareness that social impact investment enables a recycling of funds that enable the philanthropist to use the money several times and generate greater social impact.

There are occasions when social enterprises generate more social impact than equivalent charities – think about The Big Issue and the superior leverage it has been able to achieve as a magazine publishing and distribution business as opposed to just another homelessness charity. Of course, there are many cases where there is no feasible way to create a viable social enterprise in a particular area and charity is the only viable mechanism to generate a particular social good (such as disaster relief, for example) – but in the interest of getting money to stretch further there are other occasions where the entrepreneurial and socially impactful business can generate a far greater social return on capital.

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Sometimes people ask us if social investment is going to replace philanthropy, if it will make it obsolete. In such an early-stage market, it's impossible to tell just how far social impact investing might go – but there will always be a place for philanthropy. That might be through 'priming the pump' by providing capital to risky ventures that have not yet proven their model, or providing grants so that entrepreneurs can accurately measure their social impact, or even offering innovation funding for products – like Solar Suitcases – that need support to develop a market in developing countries. Acumen is a great example of this, where their work on market development in emerging economies has been absolutely key in laying the groundwork for later social investment.

Philanthropists are key to the development of social impact investing, but they are not the only players out there. Social investment can also come out of the investment pot.

Many of our clients have portfolios where they seek to generate a satisfactory level of returns. Some people worry that they will never make returns in impact investing. However, product innovation in such areas as clean tech and micro-finance has meant that investors can generate acceptable returns - and generate social impact essentially for free. Other areas are also emerging – such as social housing. For an increasing number of investors who are growing in their understanding and appreciation of social impact, this 'free social impact' has proven very attractive.

At ClearlySo we have seen our broad network of individual investors grow from 100 to well over 400 in the past two years. We knew that demand was growing, and we kept hearing from investors that they wanted to engage at a deeper level, to support early stage ventures, to use their influence and networks as well as their capital - so Clearly Social Angels (our most intensive and heavily-supported network) was born. Launched in March 2012, it now has almost forty angels who meet once a month, hear from entrepreneurs from exciting companies and invest in these businesses that generate social or environmental value. Angels invest in companies such as Playmob (a business that runs a platform behind smart phone gaming where money from in-app purchases goes to charities around the world) – and Exosect (a sophisticated technology that ensures pesticides directly target pests rather than plants or other insects, protecting environments and ecosystems).

It is challenging to be in an angel group making social impact investments. Although we guide them through the due diligence process, they have to know about the entrepreneur's plan to scale, measure and report on their social impact, how a company's social value must be locked in to its plans for growth, expansion and exit – as well as all the usual questions about commercial viability, marketplace positioning and valuation.

Of course, some investors and philanthropists who are just starting to explore social impact investing will tell you how difficult it is to find investment-ready businesses. To some extent, this is true. There are a lot of early-stage companies out there creating positive social impacts, but many of them are not yet ready for investment. That's where angel groups and intermediaries can help; they find the right businesses, they screen them, and they bring them to investors. The government has also invested in programmes like the £10m Investment Contract Readiness Fund, where businesses receive support from advisors like ClearlySo to help them become investment-ready. The businesses are out there, and they need angel capital to scale their impacts, but sometimes you'll need to partner up with others – other angels, other philanthropists, advisors or intermediaries – to find the right ones.

We are only just at the beginning of this exciting journey but it is great to see it being led by investors and philanthropists alike. Perhaps the crash, for all its damaging aspects, has a silver lining - it is forcing us to think much more deeply about the best ways of achieving socially positive outcomes we all desire.