The value of being human:
A behavioural framework for impact investing and philanthropy

Greg B Davies *(www.centapse.com)*

As investors increasingly seek to use their wealth to deliver positive social outcomes, as well as financial ones, the need to understand how emotions can affect decision-making is all the more valuable. How can investors strike the balance between combining their social objectives with financial goals? And what are the emotional and behavioural barriers both to donating wealth, and engaging with impact investing?

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Building on our existing work as industry leaders in the application of behavioural finance to wealth management, we recently launched The Value of Being Human: a behavioural framework for impact investing and philanthropy. Our aim is to provide investors with a framework and tool to help them better understand themselves, their needs and how best to approach the complicated question of doing social good with their wealth.

The research that helped inform the development of this framework shows that investors are keen to embrace impact investing, but turning these good intentions into a comprehensive investment strategy is proving harder to achieve.

There is clear evidence of a desire to do social good through investments (almost two thirds of the respondents to our surveys expressed interest), but until now investors have been ill-equipped to navigate this complex area with any degree of confidence (fewer than one in ten had actively engaged). This means there is considerable untapped demand from investors to find clear ways of expressing their social preferences through their investment portfolios.

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To unlock latent demand for impact investment, we need to focus on the needs of the investor at least as much as on the supply of products. Just considering financial needs is complex enough; adding in social considerations is extremely daunting, so most investors keep things simple by expressing their social preferences only through philanthropy. Our framework seeks to help investors approach the appealing, but daunting, set of opportunities of the middle ground of impact investing with comfort and confidence.

However, ultimately we wish to help investors tackle the broader, more fundamental question: what is the best way to do social good with my wealth? This means helping them not just to approach impact investing, but rather the full range of options, from philanthropy, to impact investing, to traditional investing. It is essential that we include both philanthropy and impact investing; these are both viable options and we don't want to discourage philanthropic activity when promoting impact investing.

Although people are already clearly prepared to donate to charities, it is questionable whether the amount they give is sufficient to optimally satisfy their social objectives. Just as investors will shy away from impact investing unless there are clear guidelines about how to go about it and how much to do, in philanthropy most people lack a clear framework that enables them to work out how best to give.

As with most things in life, if we are unsure what the appropriate action is, our natural human tendency is to retreat from the problem, and as a result do less than we would if we had a clear mental anchor of the right solution. For example, evidence suggests that the amount people give is determined more by their income than their wealth. The result is that the wealthier people are, the lower the percentage of their wealth they donate.

Providing donors with a clear, and personalised, recommendation of how much of their wealth would be appropriate for them to donate each year will remove the seeds of doubt that result in people not engaging with philanthropy as much as they might.

We have already seen the effect of providing clear mental anchoring points for the super wealthy through The Giving Pledge campaign to encourage billionaires to donate at least half of their wealth. The very recent pledge of Mark Zuckerman to give away 99% of his Facebook shares in his lifetime provides a further mental anchor to encourage giving. With an anchor of what to aim for, people become comfortable with doing more.

Our framework, which was built on extensive statistical analysis of data from two surveys of nearly

1,000 UK respondents each, starts with 24 simple questions that provide each person with a profile of their social preferences relative to the population as a whole. This helps investors to understand their own attitudes and motivations. The next step is to turn each profile into a set of guidelines that gives each person a personalised recommendation for how they should set about structuring their wealth to align to their own social profile. We have tried to do the heavy lifting for people to give them a clear way of approaching these complex issues.

Based on their profile scores on three attitudinal dimensions, each individual is given a social budget of credits that they are encouraged to 'spend' each year by channelling their wealth to social good. The three dimensions are:

- **Social/Financial balance:** your willingness to trade-off financial outcomes for social outcomes
- **Moral duty:** your need to change society for the better
- **Personal satisfaction:** the emotional rewards you get from being involved and doing social good.

Individuals who show high scores on each of these dimensions are allocated a larger budget and low scores get a smaller budget. This aligns the recommendations to individuals' attitudes and what they are comfortable with.

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The budget is then split between philanthropy and impact investing, again based on individual responses to questions that indicate the degree to which each is more comfortable with the immediacy and directness of giving money away, or with the idea of investing for good. The philanthropy allocation is then translated directly into a suggested percentage of wealth that the individual should donate every year. These values, which will typically be around 0.5% of total wealth per year, but could be substantially higher, have been calibrated by looking at the actual donation levels of individuals with each credit allocation and then increasing these somewhat. In other words, most individuals going through this framework will be encouraged both to think of donations as an annual percentage of wealth, not income, and also to somewhat increase their donation levels relative to their existing giving.

On the impact-investing side, the credits are also linked to how much of your wealth you would be prepared to forego per year. However, in this case each credit relates approximately to the financial sacrifice you would make to do social good, rather than an amount you would give away. This could be through giving up returns, through taking additional risk, or by committing funds for long periods of time, and thus sacrificing liquidity. The credits form a neutral currency that allows us to incorporate the full range of impact investments and product types.

Giving an investor a budget of credits to spend is a bit like setting yourself a daily calorie limit if you're dieting. You may want to consume no more than 1,500 calories, but you can choose whether to eat them all at once in one giant chocolate muffin, or whether to eke them out more slowly on carrots and celery. When we look at the range of things investors can do to use their credits, some require a substantial financial sacrifice (e.g. philanthropy) and some relatively little (e.g. ESG (environmental, social and governance) filter funds of traditional investments). Our framework allows investors to aim at the right level of sacrifice for them, while doing so with a mix of approaches that is most comfortable to them.

Overall, if investors follow the personal recommendations of our profiling tool and framework, they will typically increase somewhat their current level of charity donations, and in most cases give up an approximately equivalent amount of wealth annually through their impact investments. The average individual would more than double the annual flow of their wealth to socially beneficial activities.

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Some investors are also likely to help themselves financially through impact investment in a hitherto unrecognised way. Many have existing portfolios that are cash heavy, too liquid and too focused on the short term. By nature, many impact investments are longer term and less liquid. Putting money into these may not just provide social dividends, but could also encourage them to deploy cash that they have been unable to bring themselves to put to work, resulting in a better portfolio structure in purely financial terms.

Too much writing on impact investment has the underlying assumption that, 'if you build it, they will come'. Various ambitious projections based on a few years of growth – including one giving a six-fold increase in assets under management between 2015 and 2020 – are based largely on extrapolations of increasing supply. Instead, we suggest bringing more focus on investors themselves, to better understand what holds them back from a market that clearly interests them, adding to the current discussions and enabling the industry to achieve its potential.

***Greg B Davies, PhD** is the Founder of Centapse – Decision Science, Applied. He is an expert in applied decision science and behavioural finance, turning academic insight into practical applications.*

In April 2016 he founded Centapse, a firm dedicated to applying sophisticated behavioural insight to design, develop and deploy solutions across industry to help people (and organisations) make better decisions.

Greg started, and for a decade built and led, the banking world's first behavioural finance team as Head of Behavioural-Quant Finance *at Barclays. He was the architect of Barclays' behavioural profiling tools and holistic Wealth Philosophy, delivering solutions tailored to both financial and emotional investment needs; and he designed Barclays' innovative behavioural approach to impact investing and philanthropy.*

He holds a PhD in Behavioural Decision Theory from Cambridge; is an Associate Fellow at Oxford's Saïd Business School; a lecturer at Imperial College London; and author of Behavioral Investment Management.

Greg is also the creator of Open Outcry, a 'reality opera' which premiered in London in 2012, creating live performance from a functioning trading floor.
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