Is impact investing ready for the next step?

Topic of the month Februar 2016

The next step

In the past year, impact investing has definitely developed from a nice to have-concept to a major strategy in financial management. The number of publications on the topic has risen and the promoting organizations such as the Global Impact Investing Network (GIIN) or Swiss Sustainable Finance (SSF) have received increased media coverage. The Global Sustainable Investment Alliance (GSIA) estimates that globally USD 275 billion of investments are based on impact investing procedures. This is not much compared to the 9000 billion invested based on negative screening, but impact investing shows high growth rates.

However, the new fame attracts many prospectors. Being the new buzz word of asset management raises the danger to being undermined. In search for attention and newness, banks and fund manager start using the term “impact investing” for many products that used to be labeled sustainable investing or socially responsible investing before. But there are some constraints to be respected if you really want to go into impact investing.

Basically, impact investing intends to create positive social impact beyond financial return. Thus, it bridges the gap between philanthropy and financial investment. A very important criterion of impact investing is the proactive approach by the investor. Instead of just giving money to someone and expect a higher value after some time, impact investing asks the investor to question and observe the impact of the investment. A consistent impact investing process starts with the values and intentions of the investor. They set the barriers for the future investment and direct to possible fields of interest. These may range from clean water in Africa or regenerative energy power systems, to internet access for poor people, or education for migrants. Afterwards, and based on a due diligence process, concrete projects or companies have to be found for a direct investment and evaluated based on the intended social benefits. Not every social initiative can create economic return and not every start-up is a social enterprise. After the investment has been made, the investor has to wait for the results in order to measure the impact created by the investment. But the manifestation of the intended impact may be visible only after several years. Hence, impact investors have to be patient and long-term oriented. Altogether, impact investing is more like a private equity investment instead of classic market investment. Anything apart from an active asset management cannot be counted as impact investing.

Is this expensive? Yes. If you do pure philanthropy, you have to check if a project has the potential for the intended social outcomes. If you do pure investment, your due diligence process will be focused on the financial return. For impact investing, you have to do both.

This is not marketable? Maybe. Think of the development of microfinance. Started in the 1970s, private funders donated to nonprofits that issued micro credits. As the size of donations grew and procedures became more effective, larger charities and foundations took over and further developed the field. Finally, business investors discovered microfinance as a market with constant returns. During the past decade, microfinance finally was one to the most effective field for investments.

The same could happen to impact investing, but hopefully in half the time. What do we need to do? Instead of shaping impact investing into a “one-size fits it all”-feel-good solution, markets and governments should think about, what has to be changed to make impact investing possible on a large scale. Especially, the guidelines for institutional investors – pension funds etc. – have to be adopted to allow for more impact investing. The Social Impact Investment Taskforce, established under the UK’s presidency of G8, made first attempts into this direction. Additionally, we need general acknowledged impact measurement principles.

As long as the measurement of impact is not comparable but always tailor-made for one project or organization, serious investors will restrain from investing. You can only control, what you can measure. One possibility is the further development of methods such as the social return on investment. Another option is joint efforts such as the Impact Reporting & Investment Standards (IRIS) by GIIN or the London Benchmarking Group for the measurement of corporate community engagement. Finally, banks and financial consultants have to change their business models. Instead of selling products and earning by fees, they need to develop business models comparable to consulting firms. Impact investing needs advice and specific knowledge. In the planning and execution of most of the social impact bonds established in the past years the traditional financal market operators were not involved. But financial intermediaries are necessary to scale up impact investing.

For 2016, impact investing is at a crossroads. Either it becomes a marketing phrase signaling some warm glow for investors seeking for a better feeling without changing anything or it develops into a stand-alone asset class with the potential to create social change and economic value at the same time.

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The Center for Philanthropy Studies (CEPS) at the University of Basel is an institute for interdisciplinary research and executive training of the nonprofit sector. The CEPS was established in 2008 by an initiative of SwissFoundations, the Association of Swiss Grantmaking Foundations. The CEPS is a research think tank which deals with the multifaceted topic of philanthropy.
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