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# PART I

# GETTING READY FOR YOUR HIP PORTFOLIO



The first step to developing your portfolio begins with a fresh perspective.

Let's start at the beginning. Being productive requires you to be healthy. Then you need to pay for your living expenses and accumulate some wealth. We would prefer to breathe crisp air and drink clean water from the earth. If you believe that every person can make a difference, then we need equality. Finally, for a community to grow, we need to trust each other.

Each of these five elements—Health, Wealth, Earth, Equality, and Trust—forms the foundation of the Human Impact + Profit (HIP) framework. It is inspired by Maslow's hierarchy of needs, and focuses on the human needs that each of us has.

Business is one provider of solutions to these everyday core needs. As a customer, you buy products that make your life easier or better. As an investor, you want to have companies that excel in the five elements in your portfolio.

While some may view solving social or environmental problems as the scope of government or nonprofits it is actually the leading

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companies today who view the world as a series of human problems to solve, and who do so profitably.

The global trends of our world line up with this new world view: that all of us want to live long, prosperous lives on an unpolluted earth that respects our individual potential and supports us working together ethically.

Companies that solve these problems will help the most people and make quantifiable human impacts on the world's seven billion citizens. These firms will also make the most money by assessing the global trends and designing their business strategies in response to these massive forces.

Chapter 1 shows you the foundation of the HIP framework that will be explored throughout the book. Chapter 2 outlines the trends that fit with this fresh perspective. By the conclusion of Part I, you will see the opportunity to be a more HIP investor—and discover how to realize more Human Impact + Profit for your portfolio and your world.

CHAPTER 1

# The Importance of Human Impact to Investors

An innovative experiment on a holiday weekend by an entrepreneurial engineer led to a new form of business: one that created bigger profits and a better world.

Back in 1995, Pierre Omidyar sought to test how an Internet-based marketplace would price used goods. The first item up for bid: a broken laser pointer, which sold for $14 (Viegas 39). Omidyar then enabled this platform for individuals to buy and sell “collectibles,” including a range of Pez candy dispensers, which he secured to surprise his college sweetheart, Pam, an avid collector (Cohen 83; eBay interview).

This experiment was so successful that it grew to become the premier online global auction site—eBay. People bid online to purchase products ranging from Beanie Babies to used computers, sending money to people they have never met, and wait for their purchase to arrive in the mail.

eBay’s launch created a platform to support hundreds of thousands of entrepreneurs’ businesses. IRS tax data shows that more than 700,000 people earn their primary income from eBay sales and for over a million others, eBay is a source of secondary income.

eBay generated a platform built on a shared need, to either buy or sell, that connects strangers and requires them to trust each other—building trust among strangers became one of eBay’s core benefits. It also promotes the reusability of goods, empowers entrepreneurs globally, and generates healthy competition, which consequently lowering prices. With the PayPal money-transfer and trust service, buying and selling over the Internet accelerated.

Essentially, eBay created a vibrant, interconnected, trusting marketplace that enabled customers to save and entrepreneurs to thrive by trading existing goods. It created positive human impact by design and was financially attractive for all involved—the buyers, the sellers, and eBay itself. The growth of the business produced natural benefits to society—human, social, and environmental. Today eBay serves 88 million customers, more than 1 in 100 people globally, who trade more than $10 billion worth of goods every three months (eBay Inc. Web site). Shareholders, entrepreneurs, and the company's founders profited as the site grew to a global audience and became a new mode of commerce.

The founder, Pierre Omidyar, and the first president, Jeff Skoll, made substantial profits from their venture and reinforced what they already knew: Businesses that build a better world perform better financially. Each has carried this lesson into their investing. Today, Pierre Omidyar—a fan of Adam Smith, markets, and self-sustaining systems—invests substantially in microfinance, the fast-growing financial industry that provides small loans to low-income entrepreneurs. Omidyar's portfolio includes $100 million of capital for institutions making these microloans, generating positive social benefits while earning a profit (Tufts e-news 2005).

Jeff Skoll has also pursued an impact-maximizing approach to investing. Skoll consistently seeks out for-profit investments that generate both societal good and financial gain. His investments include Generation Investment Management's global equity fund, founded by Al Gore and former Goldman Sachs banker David Blood.

Omidyar and Skoll both invest to generate Human Impact and Profit, also know as "HIP." As discussed in the introduction, a HIP investment approach yields higher financial returns while offering significant benefit to society. Thus, HIP investors earn bigger profits while building a better world.

How do you build a HIP portfolio? It's not as hard as you think, but first you need to start asking "How HIP Is This Investment?" Most investment funds and financial analysts ($8 out of every $9 of assets under management) tend to focus on short-term profits and traditional capitalist metrics. A small group of investment managers and their funds (about $1 out of every $9 of assets under management) seek to "do good" with "socially responsible" investing, but often underperform financially. Both ends of the spectrum need to consider Human Impact + Profit—the innovative investment approach that is designed to earn higher profits through improved human impact.

This book is written to help you evaluate your investments across asset classes for quantifiable human impact and profit, and build a portfolio that makes bigger profits by building a better world. To do this successfully, we first need to understand the building blocks of the HIP approach.

## What Is Human Impact?

In the world of HIP, "human impact" describes what people need to be fulfilled, and what society needs to thrive. We all have basic needs and desires, and are seeking to achieve our highest potential, and in doing so, realize our lifelong goals.

To be able to think beyond the day-to-day, and work to realize our long-term goals, we first must address our core needs. Famed twentieth-century psychologist Abraham Maslow developed a framework to better describe what drives people's actions and guides their purpose. Maslow posited that higher-order goals could only be accomplished if more pressing human needs were solved first. His framework outlined five categories of human needs into a hierarchy (see Figure 1.1), starting with the most basic and progressing to the most fulfilling:

1. Physiological—breathing, eating, drinking, and sleeping.
2. Safety—physical security and financial security.
3. Social and Belonging—love, giving to others, group affiliation, and inclusion.
4. Ego and Esteem—self-respect, human worth, and confidence.
5. Self-Actualization—mission in life or personal destiny.

Maslow's hierarchy shows that people must have their basic survival needs met before being able to operate at the next level. While each level doesn't have to be complete to consider the others (you can be hungry yet still share love with your family), people do need to cover their basic needs to be fully focused on achieving the next higher level. If as a child, you don't eat well consistently, your body won't permit your brain to absorb new knowledge or study


**Figure 1.1 Maslow's Hierarchy of Needs**

*Source:* Maslow, Abraham, "A Theory of Human Motivation," *Psychological Review* 50 (1943):370–396.

effectively. If a lower-income family is desperate for money, students may not even have the chance to study, but may be required to work or farm instead of going to school. People who are not fulfilling their basic needs have difficulty advancing to the next stage of human aspiration (Maslow 1943).

HIP has built a unique methodology that builds upon Maslow's Hierarchy of Needs to construct a framework focused on measuring a company's total Human Impact and how it drives profitability.

How is serving these basic needs profitable? In India, citizens have a choice—spend up to 60 percent of their income for water or send the women and children to walk two hours a day to retrieve it (Global Giving Web site). Today, there are nearly one billion people without access to clean drinking water (Water.org). Entrepreneurs around the world are developing strategies to change this—from handheld water pumps, to community wells, to communities building their own pipelines—and all for a profit. These entrepreneurs are generating significant profits while realizing positive human impact for millions around the world. With access to water secured, individuals can now invest their money and time to more sustainable and profitable ventures for themselves and their families. In fact, in some communities with new clean water projects, 40 percent of families can now send their girls to school (Global Giving Web site).

Inspired by Maslow's hierarchy of needs, the HIP framework is designed to be a "scorecard" that hones in on five core human needs: Health, Wealth, Earth, Equality, and Trust (see Figure 1.2). This integrated view is structured to guide an organization to solve these human challenges by measuring results and tracking progress


**Figure 1.2 HIP Companies Innovate to Answer Five Human Needs**

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toward the ultimate goals of providing long, healthy, and happy lives for the global population of over 6.8 billion people. In more detail, the five elements of the HIP framework are:

1. **Health** fundamentally covers physical health, mental agility, and overall satisfaction. Everyone needs to eat, drink, and fulfill basic needs as Maslow said. If you don't have your health, it's hard to do anything else.
2. **Wealth** encompasses income generation, accumulating assets, and achieving financial stability. Individuals and families need jobs to pay for food, drink, and health care, but also education, transportation, and supplies that support their human advancement.
3. **Earth** includes the air we breathe, the water we drink, and the land we cultivate. To derive benefit from our ecosystems in the future means to treat them properly today, managing natural resources to be clean, renewable, and available for future use. This also means minimizing pollution, like carbon emissions and effluent.
4. **Equality** is defined as the proportion and balance in society across gender, ethnicity, and class. As a society, we benefit most when all individuals are empowered to participate, contribute, lead, and innovate without bias or restrictions.
5. **Trust** comprises transparency of information, ethical actions, and credible decision processes. A group is most stable and durable when it shares openly how it operates, so that any decisions not consistent with the ethics, goals, and values can be constructively evaluated.

When all these goals are achieved, citizens can be happy and fulfilled; in the mind of Maslow, individuals can achieve their highest potential as all the barriers to "self-actualizing" have been removed (Maslow 1943). The HIP approach seeks to enable all people worldwide to participate in that journey and reach their highest potential, while empowering business to generate the highest returns.

## A Leading Indicator: Quantifiable Human Impact

Today's commonly accepted performance measurement systems are often not sophisticated enough to look beyond financial results.

While measuring profits and earnings is critical, there are deeper human impact costs and returns to factor in.

While a healthy lifestyle is free, visiting the doctor costs money. Thus, illness increases traditional economic value. But what about the lost value in terms of an individual's productivity? The economic benefits for healthy people are not counted explicitly, missing an opportunity to focus on being well continuously. Instead, the measures focus on the aftermath, not the root cause. As Robert F. Kennedy remarked at the University of Kansas 1968, "Our gross national product (GNP) counts air pollution . . . and television programs which glorify violence in order to sell toys to our children. Yet the GNP does not allow for the health of our children, the quality of their education, or the joy of their play . . . it measures everything, in short, except that which makes life worthwhile."

Today, there is not yet a generally accepted scoring mechanism of "human impact"—how a company performs according to factors like health, wealth, earth, equality, and trust. To date, the most comprehensive and long-term view is designed into the Human Development Index (HDI), compiled by the United Nations. It ranks "human development" results by country—from health (e.g., infant mortality), to wealth (e.g., average income, savings rate), to earth (e.g., relative pollution, water use), to equality (e.g., gender balance, girls in school), and trust (e.g., labor rights, human rights). According to the UNDP Web site, the higher-performing countries are higher-income countries like Norway, Canada, and Iceland; while the lowest are lower-income countries like Zimbabwe, Botswana, and Congo. This happens for two reasons: one is that economic value is part of the equation for calculating HDI; the other is that higher impact requires financial capital to make improvements in quality of life.

HDI is compelling because it quantifies a more complete state of human conditions, not just the amount of money related to GDP. While higher-income countries tend to have higher human-development scores, and lower-income countries tend to have lower-development scores, there are exceptions to this general correlation. Let's examine an innovative measurement model that goes much further than traditional GDP to focus on multiple dimensions of quality of life.

Bhutan is a small, isolated country on the edge of the Himalayas in Asia, with a population of nearly 700,000. Throughout the twentieth century, Internet, and TV were banned and a tourist visa cost more than $100 per day. In 1972, Bhutan's former King Jigme Singye Wangchuck sought to ensure the country's long-term well-being. In contrast to traditional metrics, he developed the concept of "Gross National Happiness," which rates various measures of quality of life and personal satisfaction, including nine overall dimensions including health, psychological well-being, living standards, community vitality, and the use of time in a 24-hour day. In total, it assesses 72 indicators that add up to an indexed score of happiness. Despite Bhutan's low per capita income, Bhutan rates in the top 20 for "happiness" on a global scale (Seth 2009).

Other countries have started to follow in Bhutan's path in an effort to measure human impact beyond GDP. In 2009, France's President Nicholas Sarkozy appointed a 22-member commission, including Nobel Prize laureates Joseph Stiglitz and Amartya Sen, to understand the full scope of well-being and its multiple dimensions. The report recommended that economic indicators must look beyond production to overall wealth and income, including health, the environment, and inclusive political voice and governance. Sarkozy supported the conclusions enthusiastically: "We're living in one of those epochs where certitudes have vanished . . . we have to reinvent, to reconstruct everything. The central issue is [to pick] the way of development, the model of society, the civilization we want to live in" (*Wall Street Journal* 2009).

It is no longer just growing profit or accelerating GDP in a vacuum. The world needs a new, comprehensive view that measures how society will advance. This requires a redirected focus—a HIP framework for companies to evaluate their total potential for Human Impact + Profit.

## Human Impact + Profit = Twenty-First-Century Measurement

The HIP Scorecard is designed to look beyond each of these approaches and to build a tool for companies to measure and manage their results across the five categories of Health, Wealth, Earth, Equality, and Trust, and for investors to gauge which companies are delivering the highest human impact and profit. HIP is essentially a Human Development Index for companies—with it, investors can determine the Human Impact + Profit of each firm in their portfolio.

This is not a subjective approach. As Maslow explains, by serving our most basic needs, we create a society that enables all of its members to achieve higher levels of fulfillment. By designing the systems that allow our society, including business, to align around those human needs, we all can achieve our maximum potential.

### *Profits, Profits, Profits*

The crux of HIP's model is that each of HIP's factors is a leading indicator for shareholder value and profitability. When you evaluate a company by HIP's fundamentals, and build a portfolio that maximizes leaders and minimizes laggards, you can realize a higher return—even adjusted for risk—and an improved society. Now that's HIP.

Currently, investors tend to only measure and track the output of financial results: revenue, profit, and financial capital. That's the equivalent of only measuring GDP (the successor term to GNP). Because GDP is not a leading indicator, and hence has no predictive value of what's to come, its focus is to make the most money across a short time frame. But a short-term, profit-only approach has its downside—greed incurs excessive risks, and doesn't maximize long-term results. Financial statements provide a stark example: People are tracked as an expense on the income statement, not as an asset on the balance sheet. Yet innovation could not happen without the new ideas and management of the people who work in and manage the business. These systems lead to the mindset that staff is disposable, whereas in reality they create the value that allows the business to generate revenue and profit.

HIP's portfolios speak to the power of this approach—over the past five years, HIP portfolios have outperformed those weighted only by market values by 4 percent (or 400 basis points) on average, as seen in Figure 1.3.

### *Risk versus Reward*

Recent financial volatility has been driven by several factors:

- Constrained supply of energy, oil, and natural resources leading to higher prices
- Population growth coupled with a desire to live well
- Excessive, double-digit inflation in providing health care
- Lack of equal access to opportunity
- Desire for an open society that is honest, ethical, and truthful

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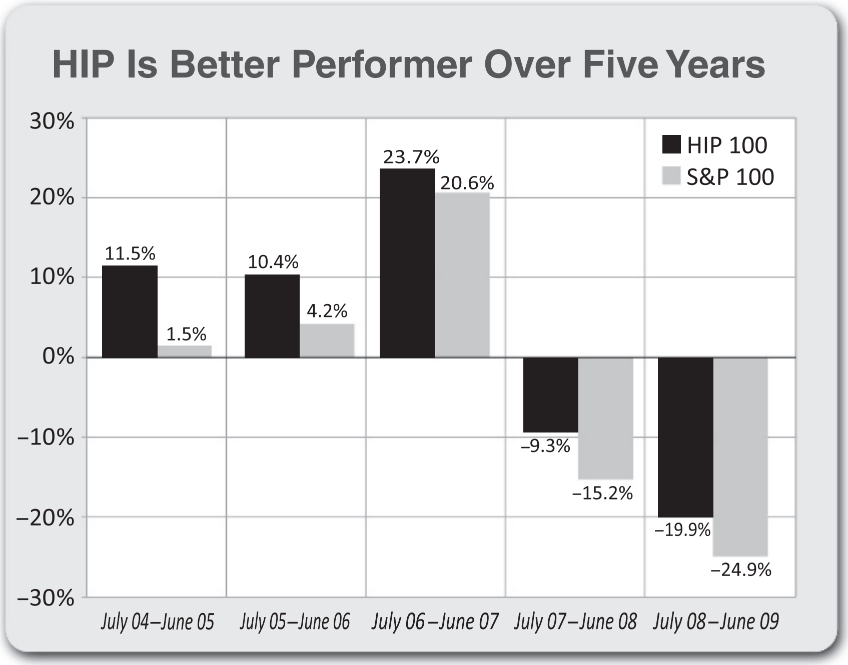


**Figure 1.3 HIP Is Better Performer Over Five Years**
*Source:* S&P, Bloomberg Financial L.P.; HIP Investor portfolios and analysis.

These factors and their resulting impacts on society and future profit are not accurately priced into current stock prices. While finance theory says that the market prices are perfect with all available information, the HIP methodology and academic studies show that leading indicators of performance are not incorporated on a timely basis. This gap between everyday market prices and the true valuation of forward-looking fundamentals creates an opportunity for HIP investors to profit, all by building a better world.

The new HIP fundamentals of investing focus on a long-term view, not just short-term profit maximization. Risks must be weighted as strongly as reward, especially those that are related to the environment or society. A more comprehensive, end-to-end view not only lowers risk but increases returns. The world of investing goes beyond pure financial ratios, but includes societal impacts. These have been previously discounted, not priced at their true value or seemingly have no worth at all.

In books on finance and economics, social and environmental factors are typically referred to as "externalities," or, in other words, something out of the company's control. But leading HIP companies view them as "internalities," critical to include the enterprise's mission and solved by its people. Eliminating water, air, or land pollution actually saves companies money, and avoids future liabilities and lawsuits. Even retraining and education of workers creates business benefits, forgoing the costs of firing and rehiring staff and potential culture clashes. When these "externalities" are assessed and counted as if they were internal costs, the cause of those factors and the ultimate results become more closely aligned. It's similar to the "total cost of ownership" concept, but adapted for a longer duration, and fuller view of the world.

Creating innovations and productivity in these markets for human needs enables the pioneers of those solutions to solve pressing problems and capture the rewards of the first mover: the trust of new customers, the pricing premiums of innovations, the branded recognition as a market leader, the magnet for the best talent to join that organization. As the rest of society purchases these HIP products, companies realize not only profits, but human impact, as well.

HIP's new investment approach is revolutionary in its potential. HIP shows that firms that quantify the difficult-but-not-impossible metrics of the human, social, and environmental factors across society can be rewarded with previously undiscovered business value.

## The HIP Mindset Is Already Here

Until October 2008, capitalists were winning the argument that short-term profit maximization delivers the most value. The risks of that approach deeply drained the portfolio values of many investors. Many investors are now seeking something different, but haven't found it quite yet.

Today, there is broad support for a HIP mindset among consumers, employees, company leaders, investors, and their advisers. While the traditional belief espouses that seeking human, social, or environmental benefits in your portfolio requires an investor to give up financial returns, HIP's in-depth findings show that optimized businesses require a more multidisciplinary approach.

Nearly two in three (65 percent) consumers want to buy products and services from firms that deliver social good, which is determined by how the firm treats employees and the environment, not its charitable giving, according to a National Consumers League survey in 2006. Consulting firm McKinsey validates those numbers as well with its research, reporting that two in three consumers also report taking action in response to companies viewed as "against the best interests of society." Nearly half (49 percent) refused to buy socially irresponsible company products and 38 percent recommended that others not buy those firms' products. Nearly half (47 percent) of consumers are researching companies online to seek out their social and environmental performance.

The super-majority of Americans surveyed about their workplace feel strongly that benefiting society is important. More than 3 in 4, or 77 percent, people say that "commitment to social issues" affects where they work. This is up from nearly 1 in 2, or 48 percent, just a few years earlier. Today, more than 7 in 10, or 72 percent, also want their employer to do more for social causes. (See Figure 1.4.)

The good news is that 84 percent of global executives believe that their companies can deliver "both high social impact and above-average financial returns." However, only 3 percent reported that their firms are currently doing a great job.

This creates an opportunity for investors. Companies who act on these trends are well-positioned to tap new customer demand, attract talent, and deliver shareholder value. Companies who don't see this opportunity risk alienating about a fifth of individual investors (19 percent) who would refuse to invest in stocks of companies who avoid "doing good" (McKinsey).

While trusted financial brands have created unique indexes like the Dow Jones Sustainability Index and FTSE4Good, these indexes have not reliably outperformed the pure-profit capitalist approaches. Increasingly, large financial players are beginning to participate with a HIP view. The Carbon Disclosure Project, which measures environmental metrics including carbon emissions, has attracted the involvement of institutional investors managing $55 trillion in assets (CDP 2009 Global 500 Report). The Equator Principles, which specify social and environmental criteria for infrastructure projects around the world, has been adopted by global banks for about 80 percent of the capital financing of those projects (IFC blog).

Despite this prevalence of a HIP mindset, investment choices for individuals and advisors remain limited. Also, most large institutional investors are skeptical without years of data to show consistent

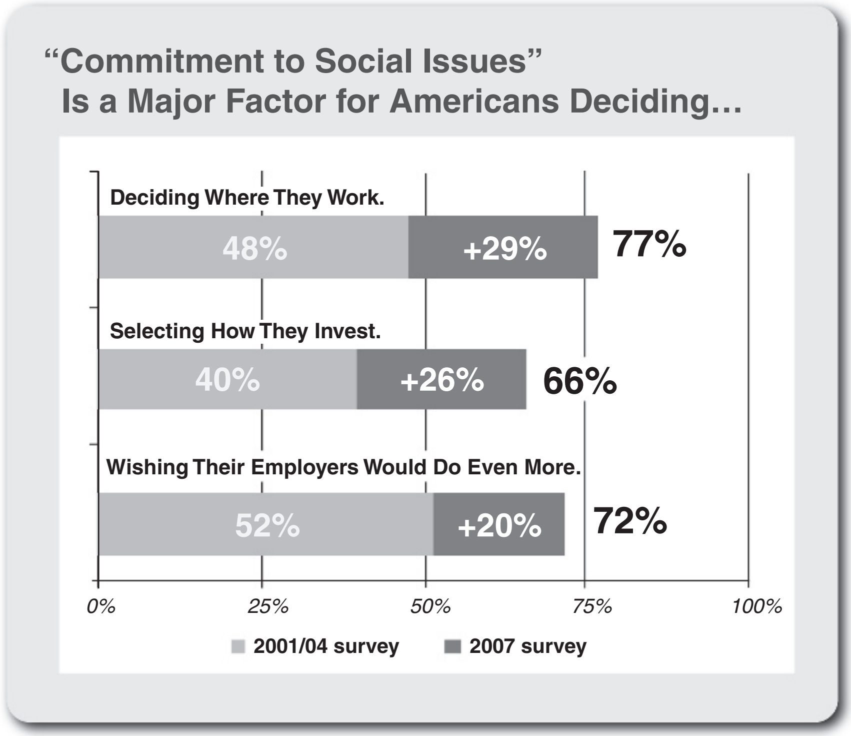


**Figure 1.4 Commitment to Social Issues**
*Source:* Cone Inc.

outperformance. However, the proof of positive performance exists. This book will show you the essential HIP approach to tap into this potential. Now is your chance to become a HIP investor and transform your portfolio to capitalize on these trends: to make more money by doing more good.

## Seeing the Light

By looking through a HIP lens, innovators capture new opportunities before others who are playing the old game. Businesses that look forward to assess all the global trends, bring products to market, count their human impact, directly link it to profit, and embed all of this in their approach—capture more financial benefit (on average, at lower risk) and help advance society. This results in happy

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shareholders, fulfilled employees, satisfied customers, and a strong supply chain (the ecosystem of job creation). Most investors know intuitively that this is the case, including sophisticated investors like Pierre Omidyar, Jeff Skoll, Leslie Christian, Nancy Pfund, Al Gore, and Vinod Khosla.

A HIP approach to the world's problems will lead to solutions that are financially attractive, lower overall risk, and improve society. Will you be a HIP investor? Let's start with the big picture—assessing the big global trends in Chapter 2.