Chapter One

# What Is Impact Investing?

Lately, it seems like every financial institution, from Vanguard to KKR, wants to sell you something with impact in the name. But with no clear definition of impact investing, how do you know if there is anything different about these investment funds? This also begs the question—what impact is each of these funds striving for? And do you agree with the goal?

There are also many mistruths and misconceptions about impact investing that lead to unsubstantiated skepticism.

One myth is that impact investing is a socialist conspiracy theory to redistribute wealth. Some critics conversely suggest impact investing is the capitalist way of extracting more profit from those in need. I've had people tell me it's only for liberals, and others say it's only for religious conservatives. It won't make money. It won't do good.

As impact investing found its way to mainstream media, I found it difficult to understand the logic behind such sensational and contradictory depictions. It's misunderstood, as the field has a long, winding history and a large tent that includes many approaches. I stumbled upon the idea 20 years ago and have had my own journey trying to figure out how to turn impact investing into a career. I can assure you, it does not have to be complicated, and you can apply it to your own portfolio if you break down the core principles.

Before I provide an accurate definition of impact investing, let me first set the record straight on some of the myths.

- **Myth: Impact investing won't make money, as you have to sacrifice returns to do something good.**

  ***Truth:*** It is possible to generate a range of financial returns while driving a positive impact. Many impact investments target returns that are in line with nonimpact investments. Other impact investments purposely target lower returns to create a type or amount of impact that otherwise wouldn't be possible but are often necessary to prove a market or catalyze future investment by those seeking market-rate returns. The common thread is an objective to create *some* amount of financial returns *and* social impact, with the investor needing to be clear about what amount of each in order to be held accountable for that.

- **Myth: Impact investing is just a marketing scheme.**

  ***Truth:*** Unfortunately, there are investment funds that use the label *impact investing* opportunistically with little to no intentional strategy or process to create any impact. However, those are simply bad investments. They don't define what one should expect. This same misbehavior can be found in other investment strategies and industries. I'm confident that with time those misusing the label will face consequences, from lawsuits to obsolescence.

- **Myth: Impact investing is a driver of woke capitalism.**

  ***Truth:*** The myth to bust here is the very idea of "woke capitalism," which is the belief that corporations seeking to communicate and operate in a way that is aligned with social goals—such as gender diversity, climate mitigation, or voting rights—is an overextension of their role in politics. Corporations have always tried to influence public policy. Just take a look at the billions of dollars spent yearly on lobbyists.[1] The rise of impact investing has also led to more CEOs feeling empowered and incentivized to speak up and change their management practices around impactful issues, making their involvement and position on topics more transparent to their employees, customers, and the public.

- **Myth: Impact investors are trying to displace philanthropy and nonprofits.**

  ***Truth:*** Nonprofits take on many challenges affecting vulnerable communities that only they can address, and philanthropy is an essential resource for this work. Impact investors believe that for-profit companies can help address or lessen many of the large challenges facing society and be partners to both philanthropy and government. Impact investing is not *the* solution, but it is an important part of the solution. For example, no amount of impact investing dollars will solve climate change; the challenges facing the planet require grant funding and other forms of philanthropic capital. Impact investors seek to provide an additional type of capital and alternative solutions to help mitigate and adapt to climate change.
- **Myth: You can't "prove" the impact of impact investing as it's not measurable.**

  ***Truth:*** Reputable impact investors can and do measure impact in accurate and verifiable ways. However, there are practical considerations, from cost to time horizon and privacy, that affect the level and type of measurement methodology. This variety in approach creates a lack of standardization, leading to the myth that measurement isn't possible. Foundations that provide philanthropic capital to nonprofits face the same measurement constraints despite decades of standardization attempts. Leaders in both impact investing and philanthropy support improvement in this area.

- **Myth: Impact investing is a fad, and real investors and business leaders don't care.**

  ***Truth:*** The consistent growth in impact assets under management throughout boom and bust markets shows no sign of waning (Figure 1.1). This trend is apparent in nearly every asset class and geography. The number of investment firms and business executives showing an interest in developing expertise or offering in this space supports that the industry is here to stay.

- **Myth: Impact investing is only for liberals, for the religious, for the rich, for the young, etc.**

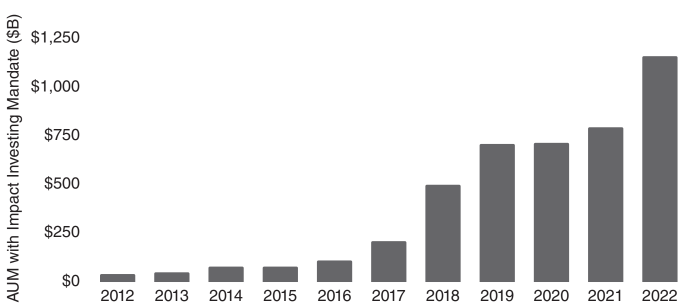
  ***Truth:*** Impact investing is not a monolithic application but is based on a set of core principles to allow for a diversity of objectives and approaches.

  I don't know how this myth got started, as individuals and organizations of various social, religious, and economic statuses participate equally. For example, the Catholic Church and the Ford Foundation are known to invest their dollars in alignment with their unique missions. At Impact Engine, we have investors ranging from those in their 80s to those in their 20s, and often, generations come together within families to invest with impact.

- **Myth: Impact investing is a small market with limited options.**

  ***Truth:*** With more than $1 trillion of assets under management and growing, there is an increasing depth and breadth of impact investment options. As more dollars and talent roll into the field, this will only improve further. Many families and foundations, like the Nathan Cummings Foundation's $500 million endowment or the California Endowment's $4 billion, have already committed to investing all their capital with an impact lens.

**Figure 1.1 Sizing the market**




*Source:* GIIN Annual Impact Investor Survey. The GIIN. (2015–2022). https://thegiin.org.

With some of the myth-busting now behind us, let's explore what defines an impact investment. While impact investing has a history rooted in the environmental, social, and governance (ESG) industry, which we will cover in Chapter 3, impact investing as a defined investment approach began in 2007 thanks to the leadership of the Rockefeller Foundation.

That year, the Rockefeller Foundation hired Anthony Bugg-Levine to lead a new effort in-house and brought together roughly 40 practitioners to their retreat center in Bellagio, Italy, to collaborate on bringing a clear definition to the marketplace.[2] They knew it was possible to drive impact outcomes with their investments, but there were such wide-ranging strategies and results that a unified view of impact investing was needed to understand its growing role in the portfolio.

For example, the Acumen Fund was started by Jacqueline Novogratz, who invested philanthropic dollars in revenue-generating social enterprises in East Africa and South Asia to recover most but not all of the capital invested.[3] Muhammad Yunus established the Grameen Bank to lend directly to women in Bangladesh, taking on risks that other lenders would typically avoid while also innovating a support model that allowed for positive financial returns.[4] In U.S. markets, DBL Partners (at the time called Bay Area Equity Fund) managed a $75 million early-stage venture capital fund that invested in high-growth startups, including Tesla.[5] Despite the wide range of security types, risk and return targets, and impacts each investment firm was striving for, something in common connected them all and separated these strategies from other socially responsible investments and ESG funds. They were all attempting to have a social and environmental impact with their capital while also delivering some level of financial returns.

The Rockefeller Foundation was not the only organization that had begun to explore how these kinds of investments would further their charitable grants. W.K. Kellogg Foundation, JPMorgan Chase Foundation, MacArthur Foundation, and the Annie E. Casey Foundation were among the other early leaders. Additionally, a number of prominent family offices, including Mitch Kapor, Justin Rockefeller, Liesel Pritzker Simmons, Jeff Skoll, and Charlie Kleisner, were beginning to invest their personal wealth in this manner. Initially, these were mostly mission-oriented organizations and families committed to exploring the potential financial and social return of these strategies.

One issue the Rockefeller Foundation identified early was the need to accurately measure the impact of these kinds of investments. There was not enough data to categorize the myriad of approaches into likely outcomes. Still, the Rockefeller Foundation and some of the other early impact practitioners did have a common belief that sharing their learnings could create a broader market and crowd in more capital. Subsequent to the Bellagio convening, the Rockefeller Foundation created the Global Impact Investing Network (GIIN) to share learnings with the goal of educating the broader public about impact investing and advancing the various approaches.[6] Headed up by Amit Bouri, the first job of the GIIN was to bring definition and clarity to the impact investing space.

The Bellagio attendees also created, and the GIIN helped build consensus for, the following definition of impact investing: "Investing with the intention to generate measurable financial and social returns."[7] Since this early definition of impact investing has proved seminal to so much of the industry's subsequent work, it's worth dissecting the meaning of the three keywords to this novel and groundbreaking definition: *intention*, *generate*, and *measurable*.

*Intentionality* means an investor has an impact objective at the outset. Unfortunately, there are many examples of large asset managers claiming they have decades of experience and billions of dollars invested in impact, but these claims are made in retrospect as these firms had no impact strategy until recently. If you double-click to review the depth or magnitude of the impact they've created, there is little to show. This is because businesses that create meaningful impact require intentional, strategic decisions throughout their life.

Take a simple business like a grocery store. It's true that the grocer provides food, and that is at the very highest level of "good" for society, as we all need to eat. But the quality and price of the food and everything that goes into making it available can have a wide range of effects on its stakeholders. For example, does the grocery store prioritize an abundance of produce as you enter or strategically place sugary snacks? Is the produce, dairy, and meat sourced from industrial farms with questionable practices or local organic farms? How does the business owner treat its suppliers, and what quality of jobs are offered to their workforce? Is the business located in a food desert where access to basic food at an affordable price can change the quality of life for the community or in a high-income area that already has an abundance of options?

It's easy enough for an investor, in hindsight, to say that they are impact investors as the grocery store fed X million people. In reality, if they had had an impact intention from the start, the type of grocery store and how they managed it during the investment period would have differed significantly from a purely financially motivated investment decision. Every business has impact, both positive and negative, but intentionality sets impact-focused companies apart.

*Generate* speaks to an investor's involvement in the impact that is created. It's not enough to have exposure to businesses doing good; rather, the investor has to help in some way. *Additionality* is a technical term many in the industry use to describe this type of causal effect. Additionality could be through capital, especially if the impactful company may not have raised as much capital or at the same price had it not been for the impact investor. Or it could be through active engagement with the company to create value.

More typical value-add revolves around business strategy. For example, an investor could help a high-quality healthcare services company expand into areas with lower-income households. Another role I see investors play is holding companies accountable for their business practices, perhaps around ensuring equal access to the best jobs and professional development. Note how this form of active management is highly unlikely if the investor doesn't have the skillset for managing impact. For example, after the killing of George Floyd in 2020, there was a large wave of investment firms making statements of support for the Black community. However, many were skeptical of whether words might translate into action, knowing there were no resources, capabilities, or strategies behind these promises. They were right, and without this capability, these words fell flat.

*Measurability* is essential to assess the quality of impact. The field of measurement is developing quickly, and there are considerations of precision, practicality, cost, and quality that make for a range of approaches. We'll cover these in greater depth later in Chapter 10.

For now, it's important to understand how easy it is for investors to make false or exaggerated claims about impact if there is no measurement behind it. My favorite example is, "Ten million lives *touched*" in an impact report. What does that mean? Even worse, these same reports feature stock images of women or people of color graced by the help of a businessperson. And of course, it's printed on very heavy stock, glossy paper that will certainly be recycled (irony intended!). There is likely no real measurement happening in these investments, and that tends to go hand in hand with a lack of intentionality and a lack of active impact management.

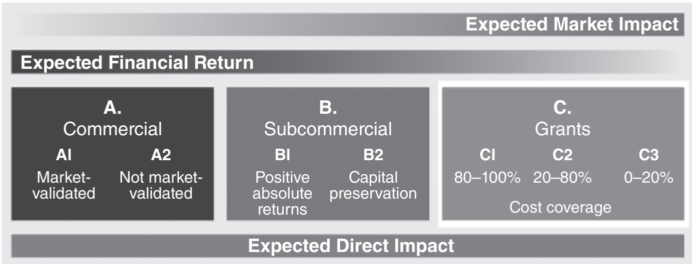
If you see the thread, what matters most to be an impact investment is that there is an impact objective. Impact is not something to consider or evaluate. It must be a core reason alongside a financial return for making the investment. This is fundamentally what differentiates impact investing from ESG investing. The latter requires only consideration of impact factors but does not call for impact to be part of the objective for making the investment. My distinction here will become clearer when we cover ESG investing in greater detail in Chapter 3.

In addition to the core components of the GIIN definition, it is also important to denote what is *missing*: it lacks any specificity of how much or what type of financial and social return should qualify as an impact investment. This is not because impact investing requires a lower than typical financial return. The myth that somehow impact investments deliver less yield than a nonimpact investment is absurd, yet the myth persists due to impact's origins with nonprofit institutions. And yes, there are impact investments that provide a below-market return, but when done correctly, it is intentional to create a certain type of impact that otherwise wouldn't be possible if it weren't for the lower rate of return, and the trade-off is described in the objective up front.

The Omidyar Network, a $1.5 billion foundation and impact investment firm started by eBay founder Pierre Omidyar in 2004,[8] shared their framework for financial returns from impact investing in a white paper titled "Across the Returns Spectrum."[9] The Omidyar Network expects the same level of direct, company-level impact across its portfolio (Figure 1.2). However, Category A: Commercial Investments, are for companies with impact embedded in their business model, and commercial financial returns have already been market-validated or there is reason to believe it will be likely. Given the market validation, it's less likely that these investments will lead to what Omidyar refers to as *market impact*, which is the effect of accelerating the development of a market that reaches currently underserved or disadvantaged populations.

For example, Tesla, the electric vehicle manufacturer with a current market capitalization of roughly $750 billion,

**Figure 1.2 The spectrum of returns**




*Source:* Bannick, M., Goldman, P., Kubzansky, M., & Saltuk, Y. (n.d.). (rep.). Across The Returns Continuum (pp. 1–22). Omidyar Network.

was, earlier in its existence as a new privately held company, considered by many to be an impact investment because of the positive environmental outcomes its business would drive. While many nonimpact investors participated in early rounds of financing, so did impact funds such as DBL Partners, which was able to achieve competitive venture capital returns.

Category B investments are considered Subcommercial, in that Omidyar accepts lower financial returns in exchange for the promise of significant market impact. For example, companies launching businesses in new markets often need more time to overcome barriers and establish a profitable business model, potentially reducing the financial return for early investors. For those companies that are successful, however, future investments may fall in Category A.

For example, Mission Driven Finance manages a real estate investment trust (REIT) that expands access to quality childcare. By owning childcare properties and being a mission-aligned landlord providing stable leases for family-based childcare, Care Access Real Estate expands the supply of affordable childcare.[10] While the REIT may provide a lower return for investors than a similar REIT without an impact focus, it enables long-term resilience of these essential businesses and improves earnings for childcare providers, who are primarily women of color.

Category C investments are grants where the Omidyar Network does not expect to receive any capital back but does expect a high level of market impact. Specifically, Omidyar's thesis is that early grant capital will enable these organizations to become financially sustainable over time by being able to cover 80–100% of their costs through earned revenues. DonorsChoose.org is an example in Omidyar's portfolio.[11] This is an online marketplace where teachers and individual donors collaborate to bring students in U.S. public schools the resources they need to learn. Originally relying on grants from Omidyar to cover its operational expenses, DonorsChoose.org was eventually able to shift to a model in which it charges fees to donors who use the site.

The GIIN's definition also does not specify an asset class, a security type, or even a stage of business. The field did emerge first in early-stage venture capital but has expanded into all corners of the investment industry today, which we will cover in Part Two. There are compelling impact investments in small businesses, farms and forests, high-growth technology startups, century-old family-owned businesses, real estate, and public companies. Debt, equity, and everything in between is fair game. The approach to generating impact is unique to each asset class, and there are a range of expected outcomes. Investors who want to drive impact from their portfolios thus have the choice to do so across all of their investments, with different tools in their toolbox, or pick one or two asset classes that align most closely with their objectives.

The diversity of objectives and approaches to impact is what makes it powerful, fulfilling, and widely applicable to investors of all types. So why did it take so long to emerge as a viable investment strategy?