



Giving Thoughts

THE CONFERENCE BOARD INITIATIVE ON CORPORATE PHILANTHROPY

Deconstructing Impact Investing

by Paul Brest and Kelly Born

In corporate philanthropy, the focus is shifting from counting inputs to measuring social impact. Yet there is considerable confusion about the meaning of social impact. And the concept is even more complex in the emerging practice of impact investing. This report, which inaugurates The Conference Board *Giving Thoughts* series, sheds light on the concepts of enterprise, investment, nonmonetary impact, and the key requirement of “additionality.” By carefully examining the parameters and assumptions underlying the “impact” in impact investments, this edition of the series lays the foundation for a more focused discussion of assessing philanthropic and impact investing outcomes.

An impact investor seeks to produce beneficial social or environmental outcomes that would not occur but for his investment in a social enterprise. In international development and carbon markets, this is called additionality.¹ With this core concept in mind, we define the practice of impact investing as actively placing capital in enterprises that generate social or environmental goods, services, or ancillary benefits (such as creating jobs), with expectations for

financial returns ranging from below market (sacrificed in favor of social or environmental impact) to above market.² This intentionally capacious concept avoids arguing about definitions and, instead, places the focus on the central question of what counts as impact.

Intentionality and Impact

Like philanthropists, impact investors invariably *intend* to achieve social or environmental goals.³ They are, by definition, *socially motivated*. Their goals may be as specific as providing anti-malaria bed nets to residents of a region in Africa or as general as doing environmental good.⁴

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In contrast, *socially neutral investors* are indifferent to the social consequences of their investments.⁵ Many endowments invest in a socially neutral manner, as do individuals who invest through money managers or funds whose only mandate is to maximize financial returns.

Perhaps there is a utopia where all investors are motivated by social as well as financial objectives, and hence where every investment is an impact investment. Even in such a world, however, as long as investors have diverse social goals, a given investor's socially motivated investment will be made in a market where other investors do not necessarily share the same goals and will therefore be socially neutral with respect to that particular investment.

Whatever an investor's intention, the fundamental question addressed in this article is one of fact: whether an investment actually has social or environmental impact (hereafter, simply "social impact").⁶ Yet while social impact can be achieved unintentionally, this does not mean that intention is unimportant. For one thing, results can be measured and impact assessed only with respect to a particular goal. Moreover, in business and philanthropy, as in all other spheres of life, people are more likely to achieve results that they intentionally seek.

One consequence of separating impact from intention, however, is that socially neutral investors can unintentionally contribute to impact—whether in terms of their own values or someone else's. For example, socially neutral investors, motivated only by profit, have contributed to the social impact of telecommunications companies in both the developed and developing world.

In the remainder of this article we explore three parameters of impact:

- 1 enterprise impact, or the impact of the enterprise itself;
- 2 investment impact, or investors' contribution to the enterprise's impact; and
- 3 nonmonetary impact, or the contribution of nonmonetary activities to the enterprise's impact.

Impact implies *but-for* causation, and therefore depends on the idea of the counterfactual—on what would have happened if a particular investment or activity had not occurred. The enterprise itself has impact only if it produces social outcomes that would not otherwise have occurred. And for an investment or non-monetary activity to have impact, it must provide additionality—that is, it must increase the quantity or quality of the enterprise's social outcomes *beyond* what would otherwise have

occurred. We will have more to say about the relevant counterfactual in each section below.

Enterprise Impact

The impact of investors and other actors ultimately depends on the impact of the enterprise they support. An enterprise can have social impact in several ways. The first two are fundamental:

- **Product impact** is the social impact of the *goods or services* produced by the enterprise (e.g., providing anti-malaria bed nets, clean water, financial services, or efficient energy).
- **Operational impact** is the impact of the enterprise's management practices on its employees' health and economic security, its effect on jobs or other aspects of the well-being of the community in which it operates, or the environmental effects of its supply chain and operations.⁷ Some of these are often described as *environmental, social, and governance (ESG)* factors.⁸

Product or operational impact can sometimes be multiplied when an enterprise operates in collaboration with others:

- **Collective impact** is the social impact of nonprofit organizations, foundations, government agencies, and businesses working together to tackle a community-wide problem.⁹
- **Sector impact** is an enterprise's social impact, beyond its particular mission, on the markets and sectors in which it operates. For example, the Monterrey, Mexico-based IGNIA "believe[s] that by providing financial and strategic support to high-impact social enterprises we can better enable them to achieve commercial success. Their commercial success will attract eager entrants and will foster the development of new industries."¹⁰ An enterprise is unlikely to have sector impact unless it has product or operational impact.

Outputs and outcomes In assessing enterprise impact, one must distinguish between outputs and outcomes. An *output* is the product or service produced by an enterprise; the (ultimate) *outcome* is the effect of the output in improving people's lives. Therefore the impact investor must answer two quite different questions:

- 1 To what extent, if any, will the intended output (whether a product or operational benefit) occur?
- 2 To what extent will the output contribute to the intended outcome? (The counterfactual is that the outcome would have occurred in any event.)

Consider an investor supporting an organization that manufactures and distributes bed nets with the goal of reducing morbidity and mortality from malaria. The focus

of the first question is whether the bed nets were manufactured and distributed. It is answered mainly by looking at the quantity and quality of the organization's outputs.

The second question is whether the bed nets actually reduced malaria in the target population. For example, they may not be properly placed above people's beds or may be used for fishing instead of protection against malaria. And even if they are used properly and the intended outcome occurs, can the reduction in malaria be attributed to the enterprise? Perhaps the reduction was due to a simultaneous vaccination or mosquito eradication program. Or perhaps the enterprise just displaced the outputs of government providers or those of ordinary businesses that did not receive impact-investing subsidies and were therefore less able to compete. The second question is typically answered by employing the same social science methods used in assessing outcomes in public policy and philanthropy—for example, randomized controlled studies, quasi-experimental techniques, econometric analysis, and the like.¹¹

The limitations of existing standards So far, the impact investing field has developed two prevalent sets of standardized metrics for assessing an enterprise's social or environmental performance:

- the Impact Reporting and Investment Standards (IRIS); and
- the Global Impact Investment Rating System (GIIRS).

Though IRIS includes some output measures, it is mainly concerned with financial and operational measures. GIIRS ratings are based on a survey spanning five categories: leadership, employees, environment, and community (which are operational), and products and services (which are output oriented).

Although IRIS and GIIRS provide first steps toward assessing outcomes, they fall short of doing so. For example, suppose that an impact investor believes that jobs in business enterprises can reduce poverty in base-of-the-pyramid (BoP) populations. IRIS and GIIRS can measure how many people an organization employs, but not the social value of those jobs.

With rare exceptions—most notably, the field of microfinance—there have been few efforts to assess the outcomes of social enterprises.¹² Evaluation of this sort is expensive, and it typically has been funded by private foundations and international development institutions such as the World Bank. The superficiality of the current rating schemes may be a consequence of the expense, complexity, and often indeterminate results of evaluations. In this respect, impact investing is not far behind philanthropy, which has not yet

succeeded in creating a comprehensive system for evaluating the performance of nonprofit organizations. However, the absence of data and analysis makes it difficult for impact investors to assess the social impact of the enterprises in which they invest.

A framework for quantifying enterprise impact If impact investors applied the same standards to social impact that they do to financial performance, they would not be satisfied with knowing that an investment will have *some* social impact. They would want to estimate *how much* impact it is likely to have. They would want to deploy their capital for the greatest impact in achieving a particular goal and, indeed, might pursue alternative goals if the expected impact was too low. The analysis of the magnitude of enterprise impact thus involves an assessment of costs and social benefits:¹³

$$\text{Social Value} = (\text{Social Benefit})/(\text{Production Cost})$$

For purposes of enterprise impact, *production cost* is the cost of producing a unit of the desired social benefit. For example, for a medical technology enterprise performing low-cost cataract surgery, the cost is the cost per person whose eyesight is restored.¹⁴ The social value is a measure of the enterprise's efficiency in achieving enterprise impact—colloquially, its “bang for the buck.”

However, describing the enterprise's social benefit as “eyesight restored” doesn't answer the question of how much value the investor places on that benefit. Health economists have developed measures of how disabilities affect the quality of life,¹⁵ but these measures do not necessarily reflect investors' social goals, which are intrinsically subjective.

In addition, any assessment of enterprise impact ought to consider net impact, taking into account the enterprise's harms as well as benefits. Suppose the equipment that doctors use in the cataract surgery (a good) is manufactured under poor labor conditions (a bad). An investor who cares about both of these values must, however crudely, estimate how they net out.

As in the case of most social programs, enterprise impact is devilishly difficult to ascertain. Because it has been analyzed at length elsewhere,¹⁶ however, we move on to the two other forms of impact—investment and nonmonetary impact—which have not previously been defined, let alone analyzed. Without enterprise impact, however, neither investment nor nonmonetary activities can have impact. Therefore, in exploring these issues, we will assume that a particular enterprise has sufficient impact to justify the investors' and intermediaries' efforts to support it.

Investment Impact or Additionality

To understand the concept of investment impact, it is helpful to categorize investors based on their motivations and financial expectations.

An investor may be *socially neutral* or *socially motivated*:

- The *socially neutral* investor makes investment decisions based solely on expected financial return.
- The *socially motivated* investor values the particular products (e.g., microfinance, clean energy) or byproducts (e.g., jobs in poor neighborhoods) produced by a business enterprise. He is therefore interested in investing in that enterprise not only for its financial returns but also to increase the quantity or quality of its socially beneficial outputs.

Socially motivated investors fall into two categories:

- *Nonconcessionary* investors are not willing to make any financial sacrifice to achieve their social goals.
- *Concessionary* investors are willing to make some financial sacrifice—by taking greater risks or accepting lower returns—to achieve their social goals.

Nonconcessionary investors are also known as “financial first” investors, while concessionary investors are sometimes referred to as “impact first” investors.¹⁷ Most “double bottom line” impact investors—investors seeking both financial and social returns—are nonconcessionary.

In the context of philanthropy, nonconcessionary, socially motivated investments are often called *mission-related investments* (MRIs) and are distinguished from *program-related investments* (PRIs), which are generally concessionary. Program-related investments are a construct of the Internal Revenue Code, encompassing investments whose primary purpose is to accomplish one or more of the foundation’s exempt purposes and where production of income or appreciation is not a significant purpose.¹⁸

Capital benefits and the concept of additionality To have investment impact requires meeting the criterion of *additionality*—that an investment increases the quantity or quality of the enterprise’s social output beyond what would otherwise have occurred. Assuming that, at the time of an investment, the enterprise can productively absorb more capital, the investment has impact if it provides more capital, or capital at lower cost, than the enterprise would get without it. The alternative is that the enterprise is already well capitalized and that additional resources have limited, marginal impact (or merely enrich existing equity investors).

Debra Schwartz, director of program-related investments at the MacArthur Foundation, has alliteratively summarized the kinds of capital benefits that impact investors can provide in terms of five P’s,¹⁹ to which we add a sixth, *perspicacity*:

- **Price** Investing in organizations without expecting market-rate returns, to provide risky, early stage enterprises an opportunity to develop and test the market
- **Pledge** Supporting social enterprises by guaranteeing their loans (The funds may never need to leave the donor’s account.)
- **Position** Taking a subordinated equity or debt position in a layered fund, in which socially motivated investors invest alongside socially neutral investors
- **Patience** Allowing for longer time horizons before exit than is typical of venture capital
- **Purpose** Working with an enterprise to understand where capital investments could be best put to use in pursuit of its social goals
- **Perspicacity** Identifying new investment opportunities that ordinary investors don’t see

These capital benefits enable the enterprise to experiment, scale up, or pursue social objectives to an extent that it otherwise could not. The first five are particularly relevant to investments that expect below-market returns. (The extreme case in which an impact investor provides capital benefits is one in which the enterprise would receive no capital whatsoever from socially neutral investors.)²⁰ The sixth, *perspicacity*, may hold the key to achieving both market returns and social impact.

It is easy to see how concessionary investors can provide capital benefits to an enterprise. Assuming that the enterprise can productively deploy additional capital, a concessionary investor has investment impact virtually by definition, since he is willing to sacrifice some financial returns to achieve social benefits and he makes available capital to which an enterprise would not otherwise have access.

However, it is less clear how and when nonconcessionary investors expecting market (or better-than-market) returns have investment impact. Under the criterion of additionality, the investment must increase the quantity or quality of the social or environmental outcome beyond what would otherwise have occurred. The counterfactual is that ordinary, socially neutral investors would have provided the same capital in any event. Under the additionality criterion,

how can an impact investor expect market returns and still provide capital benefits to the enterprise? After all, if it's a good investment, one would expect socially neutral investors to be in it as well.

Most economists agree that it is virtually impossible for a socially motivated investor to increase the beneficial outputs of a publicly traded corporation by purchasing its stock. Suppose that a socially motivated investor buys stock in a publicly traded enterprise to increase its socially beneficial outputs. Especially if—as is generally the case—stock is purchased from existing shareholders, any benefit to the company is highly attenuated, if it exists at all. Therefore, one should be highly skeptical that investments in publicly traded securities can have investment impact.

Market frictions In any event, impact investing typically does not take place in large cap markets, but in domains subject to market frictions.²¹ Although some of these frictions may deter socially neutral investors from investing in socially valuable enterprises, impact investors may exploit them to reap both social benefits and market-rate financial returns. These frictions include:

- **Imperfect information** Investors at large may not know about particular opportunities—especially with respect to enterprises in developing countries or low-income communities in the United States and other developed nations—let alone have information about their risks and expected returns. But, if socially neutral investors overestimate risks or underestimate opportunities, they will undervalue potential investments.
- **Skepticism about achieving both financial returns and social impact** Investors at large may be unjustifiably skeptical that enterprises that are promoted as producing social or environmental value will yield market-rate returns.²² Conversely, socially motivated investors' enthusiasm for a social outcome may lead them to believe erroneously that an investment is better than it actually is.
- **Inflexible institutional practices** Institutional investors have rules of thumb and practices—in effect, institutional heuristics—that simplify decision-making for typical cases but that may exclude potential impact investments that require more flexibility (e.g., longer time horizons) than the fund's practices permit.
- **Small deal size** The typical impact investment is often small compared to similar private equity or venture capital investments. For this reason, the required due diligence and other transaction costs can render the investment financially unattractive regardless of its social merits.
- **Limited exit strategies resulting from undeveloped financial markets** In many developing economies, securities markets are insufficiently developed to provide reliable options for investors at large to exit their investment in a reasonable time.
- **Governance problems** Developing countries may have inadequate governance and legal regimes, creating uncertainties about property rights, contract enforcement, bribery, and the like. Navigating such regimes may require on-the-ground expertise or personal connections that are not readily available to investors at large.

We believe that nonconcessionary impact investors are especially likely to have investment impact in conditions of imperfect information—for example, in social or environmental niche markets where impact investment fund managers or other intermediaries have special expertise or intelligence on the ground. In stable or developed markets, information is widely available, but in imperfect markets the impact fund manager may (in the words of David Chen of Equilibrium Capital), “be able to see something that you don't see.” Socially motivated investors may be particularly interested in identifying these opportunities and thus may be able to have impact even at nonconcessionary rates.

Nonmonetary Impact

In addition to providing capital, investors—typically fund managers rather than their limited partners—can improve an enterprise's social outputs by offering a range of non-monetary benefits, for example:

- 1 **Improving the enabling environment for social enterprises and investors** Governments and some foundations provide funding to improve the social, political, and regulatory environments in which social enterprises and their investors operate—essentially a market-building activity. In *Priming the Pump*, Matt Bannick and Paula Goldman of the Omidyar Network describe how “promoting competition, ensuring consumer protection, and promoting entrepreneurship can speed up...the development of industry sectors.”²³

In addition to providing public goods of these sorts, a well-designed set of investments in a sector has the potential to catalyze markets to a greater extent than the sum of random investments in individual investee enterprises. Investments in microfinance institutions have had this effect in many regions.

The **Boulder Institute** has developed scoring and rating models for microfinance institutions, established benchmarking, and introduced an open-source management information system. It has also trained thousands of MFI practitioners.²⁴

- 2 Finding and promoting impact investment opportunities** Impact investment intermediaries are critically important in discovering investment opportunities and bringing them to the attention of investors, thus helping to overcome the information failures previously noted.

Agora Partnerships identifies early-stage impact investment opportunities in communities across Central America, focusing on small and growing businesses that are too large for microcredit support and too small for traditional bank or venture capital financing. Its clients, such as the Draper Richards Kaplan Foundation, engage Agora Partnerships to pursue impact investment opportunities in the region.

The value of these activities depends on the quality of the due diligence done in selecting enterprises and ultimately, on the enterprises' social impact.

- 3 Aggregating capital and providing other investment services** Fund managers and other intermediaries reduce transaction costs by creating economies of scale. They may also provide technical assistance to impact investors (rather than to the enterprises themselves, as discussed in point 4).

Imprint Capital Advisors, a San Francisco-based advisory firm, helps foundations and family offices identify domestic and global opportunities for impact investment.

- 4 Providing technical and governance assistance to enterprises and helping them build strategic relationships** Fund managers and other third parties provide nonmonetary benefits, ranging from technical assistance to nascent enterprises to helping more mature enterprises develop relationships with customers, suppliers, and other partners.²⁵

Endeavor Global makes use of experienced business professionals as well as teams of MBA students to assist promising entrepreneurs in meeting business challenges—from raising financing to developing human resources, and creating and negotiating term sheets.

- 5 Gaining socially neutral investors** One of the unfortunate characteristics of imperfect impact investing markets is their inability to attract the large majority of socially neutral investors who demand market returns. Where such returns seem plausible, a respected institution can signal to other investors that a particular investment or

an entire sector that others may have thought dubious is actually worthy of consideration. This can prove particularly important in attracting second-round financing, once the investment target and market have been validated.

The David and Lucile Packard Foundation made an initial \$1 million equity investment, followed by a low-interest \$10 million loan, in EcoTrust, a sustainable forest management firm. The foundation's general counsel noted, "Our main reason for investing in EcoTrust Forest in this way is to demonstrate that sustainable forest practices can generate a profit so that mainstream investors will become more interested in it."²⁶

- 6 Securing and protecting the enterprise's social mission** Enterprises that produce socially valuable products often begin with a social mission. Enterprises whose social value comes from operational impact (e.g., good environmental practices or community benefits) may incorporate that mission from the outset or have it pressed upon them by investors.

In either case, over time an enterprise's management and directors may discover opportunities to increase financial returns at the expense of social impact. For example, the manufacturer of products or services designed for BoP clientele may find it more profitable to market to wealthier customers, or a microfinance institution may screen out the neediest borrowers or drift into predatory practices. The dangers are especially acute as the enterprise scales up and takes on new, socially neutral investors.²⁷

There are a number of possible protections against such mission drift, including the continual influence of socially motivated investors, embedding the mission deeply into the enterprise, contractual arrangements, becoming an accredited benefit corporation (B Corp) or otherwise adopting a corporate charter that requires or permits producing social benefits that may compromise market returns.²⁸

Quantifying nonmonetary impact As always, the inquiry into impact begins with the question: does the activity increase the quantity or quality of the socially valuable outputs produced by the enterprise, compared to what would have occurred in its absence?

If so, the question then becomes "By how much?" A good starting place for quantifying nonmonetary impact is to consider (1) investors' willingness to pay (WTP) for services such as finding opportunities, doing due diligence, and reducing transaction costs; and (2) enterprises' WTP for technical assistance and the like.

Some of the nonmonetary benefits of improving impact-investing markets accrue to the sector as a whole and do not directly redound to particular investors and investee organizations. For this reason, a full assessment must also account for those external benefits that are not adequately captured by the participants' WTP.

Where an intermediary organization secures new investors in a socially valuable enterprise, its nonmonetary impact is measured by the investment dollars that it brings to the table that would not otherwise have been invested. It is worth noting that the nonmonetary impact does not depend on whether the investors who assisted are socially motivated or socially neutral. Indeed, subject to the problem of mission drift mentioned above, to the extent that impact investors and their allies attract socially neutral investors to social enterprises producing market-rate returns, they may multiply their impact.

Making Use of the Impact Framework

How could an impact investor use the framework developed in this article to determine whether a proposed investment in an enterprise is likely to have social or environmental impact?

Define goals and research strategies First, the investor must define the social goals he wishes to achieve and research what strategies are available to achieve them. Let's suppose that the investor wishes to reduce poverty in an African country. There are many possible strategies for achieving this goal, including work in health, education, microfinance, or agriculture, and creating businesses and jobs in almost any sector. Existing studies of the relative impact of these strategies do not reveal any single best one but suggest that supporting smallholder farmers in the region is among the promising approaches. These studies may provide at least a starting point for the investor's estimation of the social value of an enterprise's outputs in this domain.

Identify the right enterprise The investor must then identify which agricultural enterprises have a track record of success in improving the economic well-being of smallholder farmers or, if they are start-ups, have a high likelihood of success. Although IRIS and GIIRS include metrics pertaining to agriculture, they do not provide much help in assessing the enterprises' impact.²⁹ However, the investor may be able to get advice from organizations with on-the-ground experience. Indeed, rather than invest directly in an enterprise, an investor may seek to overcome information deficits by investing through a fund manager with expertise in the sector.

Choose the appropriate investment Assuming that the investor has identified a promising organization and done due diligence, he must consider what sort of investment—equity, debt, terms, amount—will improve its social outputs, and then predict the expected financial return from the investment.

Assess financial return, enterprise, and nonmonetary impact Estimating the expected financial return from an investment is a difficult but familiar exercise. Estimating social return is intrinsically much harder because of the complexities of placing values on social and environmental outcomes and predicting what outcomes an organization is likely to achieve. Estimating the value of nonmonetary contributions that directly benefit an enterprise is a commonplace task that an organization engages in whenever it hires consultants. Estimating the value of nonmonetary contributions to an entire sector is a far more speculative task.

Assess investment impact In contrast to enterprise and nonmonetary impact, assessing a particular investment's additionality to determine its investment impact is a novel task that, so far as we know, has not previously been undertaken. In this article, we propose the questions that underlie this analysis. An investor who expects market returns must ask whether his nonconcessionary investment is likely to have investment impact, and if so, how much. An investor who is prepared to sacrifice market returns should ask how much he is willing to concede for the social value produced by the organization.

The estimations, assessments, and evaluations described here all involve costs—greater or lesser depending on their degree of rigor. While this report provides a framework for undertaking such analyses, we have no *a priori* commitment to a particular depth of analysis. Research and evaluation costs must be justified in terms of their likely benefits in improving the investment decision. In some instances, evaluation—especially of an enterprise's impact—may be of great value to an entire sector of enterprises and to their investors. In these cases, the sector would likely benefit if impact investors paid their fair share of the evaluation costs—something that most philanthropists have not done.

Conclusion: Next Steps in the Analysis of Impact

The fields of corporate philanthropy and impact investing would benefit from more empirical analysis of each parameter of impact—whether enterprise, investment, or nonmonetary impact. Here are a few areas that are ripe for exploration and improvement.

The immediate pressing need in *enterprise impact* is for robust measures and third-party assessments of enterprises' outputs. As with their analogs in philanthropy, IRIS and GIIRS face the challenges of multiple, complex measures, the costs of measurement, and investors' limited interest in knowing more about impact.³⁰ GiveWell, the Center for High Impact Philanthropy, Philanthropedia, and Charity Navigator 3.0 are beginning to provide donors with information about an enterprise's outputs, and occasionally outcomes, in the belief that donors will respond to reliable information presented in a clear format. It seems reasonable to believe that impact investors would be at least as responsive to easily digestible information.

In the short term, we hope that B Lab, which administers GIIRS, will continue to refine the distinction between (1) products and services versus operational metrics and (2) outputs versus outcomes. Better collaboration between the impact investing community, organizations promoting corporate social responsibility, and groups aiming to assess enterprise impact would likely improve these efforts.

The assessment of outcomes cannot be routinized in the same way as the assessment of outputs and will continue to require large scale studies of the sort done by the MIT Poverty Action Lab and Innovations for Poverty Action—studies that, realistically, will be funded only by foundations and international development organizations.³¹

Investment impact and nonmonetary impact are less well understood and are in need of rigorous case studies that examine the impact of activities in a variety of contexts. Questions to be addressed include:

- Under what circumstances do nonconcessionary investors have impact by providing capital that the markets would not otherwise provide? We believe that the investment impact of nonconcessionary investments depends on exploiting the frictions that characterize imperfect markets, but it would be valuable to see how this plays out in actual cases.
- How can market frictions be reduced so as to attract socially neutral investors to socially valuable enterprises, and who has the incentives to reduce them?
- When are grants preferable to equity investments (and vice versa), when are equity investments preferable to loans (and vice versa), and when are the various forms of support and financing complementary?
- How can one monetize the value of various nonmonetary contributions to enterprises and investors, and how can this analysis be useful in prioritizing opportunities for nonmonetary support?
- What are the appropriate roles for government and philanthropy in creating infrastructure, improving the environment in which impact investing takes place, and providing subsidies? And under what conditions do subsidies crowd out market investors or have other counterproductive effects?

Addressing these questions would produce useful generalizations that could guide the work of enterprises and intermediaries in the field as well as investment decisions.

(Endnotes)

- 1 “IFC’s Additionality: A Primer,” International Finance Corporation, September 2010 (http://www.ifc.org/wps/wcm/connect/696f81804b06f2adb09afa888d4159f8/Additionality_Primer.pdf?MOD=AJPERES).
- 2 Cf. Tracy Pun Palandjian, “Investing for Impact: Case Studies Across Asset Classes,” Bridges Ventures and Parthenon Group, March 2010, page 3.
- 3 See, e.g., “From Ideas to Practice, Pilots to Strategy Practical Solutions and Actionable Insights on How to Do Impact Investing,” World Economic Forum, December 2013, p. 6.
- 4 The more general motivation is similar to that of “socially responsible investors,” who screen out investments that they believe have harmful social effects. See Paul Brest and Hal Harvey, *Money Well Spent: A Strategic Plan for Smart Philanthropy*, ch. 8 (Bloomberg: 2008).
- 5 The characterization of investors as “socially neutral” describes only their motivations or intentions and does not mean that investment decisions made without regard to social or environmental impact may not in fact have good or bad consequences.
- 6 The matter is somewhat more complicated because the investor must predict the expected impact of an investment *ex ante* rather than knowing the actual impact *ex post*. But even a prediction of expected impact in conditions of uncertainty is more a matter of fact than of intention.
- 7 Sara Olsen and Brett Galimidi, “Catalog of Approaches to Impact Measurement,” Social Venture Technology Group, May 2008.
- 8 “The Financial Times Lexicon,” *Financial Times*, accessed July 6, 2012, (<http://lexicon.ft.com/Term?term=ESG>).
- 9 See, e.g., John Kania and Mark Kramer, “Collective Impact,” *Stanford Social Innovation Review*, volume 9, number 1, Winter 2011, (http://www.ssireview.org/articles/entry/collective_impact).
- 10 “Our Objectives,” IGNIA, accessed January 20, 2014, (<http://www.ignia.com.mx/bop/how-we-help.php>).
- 11 See, e.g., Abhijit Banerjee and Esther Duflo, *Poor Economics: A Radical Rethinking of the Way to Fight Global Poverty* (Public Affairs, 2011); Dean Karlan and Jacob Appel, *More Than Good Intentions: Improving the Ways the World’s Poor Borrow, Save, Farm, Learn, and Stay Healthy* (Penguin, 2011); For an excellent analysis of the role of evaluation in a foundation, see, Fay Twersky, and Karen Lindblom, “Evaluation Principles and Practices: An Internal Working Paper,” The William and Flora Hewlett Foundation, December 2012.
- 12 See, e.g., Jonathan Bauchet, Cristobal Marshall, Laura Starita, Jeanette Thomas, Anna Yalouris, “Latest Findings from Randomized Evaluations of Microfinance,” CGAP, November, 2011.
- 13 This is the equation for expected value. It is often applied to social programs funded by governments or philanthropy. One might argue that, when applied to a for-profit enterprise, the denominator should reflect capitalization rather than production cost. In any event, although it is often convenient to speak as if impact were a known fact, the decision whether to make an impact investment requires a prediction of impact *ex ante*. Because the success of most investments is not assured, the equation must be modified to account for the risk of failure. The governing concept is expected return (ER) or social return on investment (SROI), captured by this equation: $SROI = (\text{Social Benefit} \times \text{Likelihood of Success}) / (\text{Production Cost})$. The calculation would actually be more complicated if one applied a discount factor for benefits that occur only in the future.
- 14 A complete analysis would take quality into account. To make it simple, this example essentially elides outputs and outcomes.
- 15 For a brief overview, see Paul Brest and Linda Krieger, *Problem Solving, Decision Making and Professional Judgment*, (Oxford University Press, 2010), 376-381.
- 16 See, e.g., Abhijit Banerjee and Esther Duflo, *Poor Economics: A Radical Rethinking of the Way to Fight Global Poverty* (Public Affairs, 2011); Dean Karlan and Jacob Appel, *More Than Good Intentions: Improving the Ways the World’s Poor Borrow, Save, Farm, Learn, and Stay Healthy* (Penguin, 2011); For an excellent analysis of the role of evaluation in a foundation, see Fay Twersky, and Karen Lindblom, “Evaluation Principles and Practices: An Internal Working Paper,” *The William and Flora Hewlett Foundation*, December 2012.
- 17 Jessica Freireich, and Katherine Fulton, *Investing for Social & Environmental Impact*, Monitor Institute, January 2009, (http://www.monitorinstitute.com/downloads/what-we-think/impact-investing/Impact_Investing.pdf).
- 18 “Program Related Investments,” Internal Revenue Service, accessed January 9, 2014, (<http://www.irs.gov/Charities-&Non-Profits/Private-Foundations/Program-Related-Investments>).
- 19 Guest lecture at Paul Brest’s autumn quarter 2012 “Funding Social Impact” class, Stanford Graduate School of Business, October 15, 2012.
- 20 But the provision of funds alone does not ensure investment impact. For example, investors might demand such a high return that they compromise the enterprise’s ability to pursue its social mission by limiting the amount of capital, or by gobbling up all the available assets as collateral, or by preventing dilutive equity issuances, thus inhibiting the raising of additional capital.
- 21 World Economic Forum, *From the Margins to the Mainstream: Assessment of the Impact Investment Sector and Opportunities to Engage Mainstream Investors*, (World Economic Forum, 2013), 20.
- 22 For example, one impact investor told us that he believed that some socially neutral investors were unjustifiably skeptical about the returns from community development projects. Conversation with Michael Dorsey, Westley Group, September 11, 2012.
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About the Authors

Paul Brest is former Dean and Professor Emeritus (active) at Stanford Law School, a lecturer at the Graduate School of Business, and a faculty co-director of the Stanford Center on Philanthropy and Civil Society. He was previously president of the William and Flora Hewlett Foundation.

A leading scholar and teacher of constitutional law and co-author of the casebook *Processes of Constitutional Decisionmaking*, Paul Brest now focuses his teaching and writing on judgment and decision making and philanthropy. He is co-author of *Problem Solving, Decision Making, and Professional Judgment* (2010) and *Money Well Spent: A Strategic Guide to Smart Philanthropy* (2008).

Professor Brest joined the Stanford Law School faculty in 1969 and served as dean from 1987 to 1999 before becoming president of the William and Flora Hewlett Foundation in 2000. He returned to Stanford in 2012 to teach in the Law School, Graduate School of Business, and Masters in Public Policy program. His current courses include Judgment and Decision Making, Thinking Like A Policy Analyst, Funding Social Impact: Methods and Measurement, and Managing to Outcomes.

Kelly Born is a program officer responsible for a portfolio of grants that fall under Special Projects.

Before joining the Hewlett Foundation, Born worked as a strategy consultant with the Monitor Institute. She also has extensive experience consulting with both the government and private sectors. In addition to her experience as a consultant, Born has worked with Ashoka in Peru, the World Bank's microfinance group CGAP in Paris, Technoserve in East Africa, and both The Asia Foundation and Rubicon National Social Innovation in the Bay Area. She also guest lectures for UC Santa Cruz's course on Women and Development.

Kelly earned her B.A. in business with a minor in economics from Pepperdine University where she graduated Valedictorian. She received her M.A. in International Policy Studies from Stanford University.



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About the Series Director

Matteo Tonello is managing director of corporate leadership at The Conference Board in New York. In his role, Tonello advises members of The Conference Board on issues of corporate governance, shareholder activism, corporate sustainability and philanthropy. He regularly participates as a speaker and moderator in educational programs on governance best practices and conducts analyses and research in collaboration with leading corporations, institutional investors, and professional firms. He is the author of several publications, including *Corporate Governance Handbook: Legal Standards and Board Practices*, *Sustainability in the Boardroom*, and the annual *U.S. Directors' Compensation and Board Practices* and *Institutional Investment reports*. Recently, he served as the co-chair of The Conference Board Expert Committee on Shareholder Activism and of the Technical Advisory Board to The Conference Board Task Force on Executive Compensation. He is a member of the Network for Sustainable Financial Markets and the Advisory Council to the Sustainability Accounting Standards Board (SASB). Prior to joining The Conference Board, he practiced corporate law at Davis Polk & Wardwell. Tonello is a graduate of Harvard Law School and the University of Bologna.

About the Executive Editor

Alex Parkinson is a Research Associate in the Corporate Leadership division of The Conference Board. He specializes in corporate philanthropy and sustainability. Before joining The Conference Board in September 2013, Parkinson worked as a Senior Consultant in London and New York for corporate social responsibility (CSR) consultancy Context. He has advised some of the world's leading multinationals on CSR communications and strategy development. His clients included Bloomberg, Brown-Forman, BSKyB, Burt's Bees, Cisco, HP, International Paper, PepsiCo, Roche, Standard Chartered, Syngenta, Teva Pharmaceuticals, and Vodafone. Parkinson spent two years as a reporter and sub-editor for UK-based financial media companies VRL KnowledgeBank and Vitesse Media. He holds a BSc in Economics and International Development from the University of Bath, United Kingdom.

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For more information on this report, please contact:

Alex Parkinson, research associate, corporate leadership at 212 339 0382 or alex.parkinson@conferenceboard.org

THE CONFERENCE BOARD, INC. | WWW.CONFERENCEBOARD.ORG

AMERICAS | +1 212 759 0900 | CUSTOMER.SERVICE@CONFERENCEBOARD.ORG

ASIA | +65 6325 3121 | SERVICE.AP@CONFERENCEBOARD.ORG

EUROPE, MIDDLE EAST, AFRICA | +32 2 675 54 05 | BRUSSELS@CONFERENCEBOARD.ORG

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