Social Impact Investing: Challenges and Opportunities

An Openwell Report

September 2016
# Contents

Abstract ........................................................................................................................................... 4  
Disclaimer ......................................................................................................................................... 5  
1) What is Social Impact? .................................................................................................................. 6  
   1.1) Expected Return Greater than the Market Rate ..................................................................... 7  
2) Challenges ..................................................................................................................................... 9  
   2.1) Additionality ............................................................................................................................. 9  
   2.2) Information ............................................................................................................................... 10  
   2.3) Products .................................................................................................................................... 10  
3) Responses ..................................................................................................................................... 12  
   3.1) Accounting for Additionality: Ensuring Impact ..................................................................... 12  
   3.1.1) Expertise ............................................................................................................................... 12  
   3.1.2) Shareholder Activism ......................................................................................................... 12  
   3.1.3) Multipliers ........................................................................................................................... 13  
   3.2) Response to Information Challenge ....................................................................................... 15  
   3.2.1) The Effective Altruism Method ............................................................................................. 15  
   3.3) Response to Products Challenge ............................................................................................ 16  
4) Opportunities .................................................................................................................................. 18  
   4.1) Making Social Impact Mainstream ......................................................................................... 18  
   4.2) A Greater Understanding of Additionality and Impact ............................................................ 18  
   4.3) New Fund Structures and Partnerships ................................................................................... 19  
   4.4) Millennial and Gen Z Commitment to Social Impact ............................................................... 19  
5) Summary ........................................................................................................................................ 21  
6) About Openwell ............................................................................................................................ 23  
7) About the Authors .......................................................................................................................... 24  
Bibliography ..................................................................................................................................... 25
Abstract

This thesis is written in support of Openwell’s Social Impact Fund. It will analyse the social impact space to draw key conclusions in the following areas:

1) What are the relevant conditions for an investment to be in the social impact category?
2) What are the major theoretical and practical challenges to achieving social impact?
3) How can we respond to these challenges?
4) What opportunities are there in the space?

The paper begins with an analysis of the conditions laid out by the OECD and GIIN, before a discussion of how impact investors can achieve the Double Bottom Line. There is a discussion of the major challenges within the social impact space and how they can be resolved, before the major opportunities for social impact investments are drawn out. Most exciting is the possibility of making social impact investments that have a significant multiplier effect, attracting socially neutral investors both to the company at hand and the sector as a whole.

The discussion of additionality and how impact investors can genuinely create an impact is a key part of the paper, with a number of important conclusions. It is argued that an impact investor can invest in a financially productive company and make a social impact as long as they provide some sort of benefit that the socially neutral investor would not. This can be either a financial or social benefit.

Social impact investors are ideally located to provide both through shareholder activism: they have expertise in the space which allows them to select the best leadership teams and develop the best business models, and they have an enduring commitment to social impact which ensures they will commit the investee companies to strict and measurable social impact criteria.

This paper also looks at potential ways of developing this system, suggesting that partnering with an independent social impact assessment and accountability organisation could be beneficial and that it is worthwhile learning from highly quantitative companies in the charity sector such as the Effective Altruists. Overall, the paper argues that there is significant scope both for more research on the topic and for genuine social impact investment.
Disclaimer

This document has been prepared by Openwell LLP ("Openwell"), a limited liability partnership registered in England and Wales with number OC408742. This document is being supplied to you solely for your information and may not be reproduced by, or further distributed to, any other person without specific Openwell consent. No other person may rely or act upon it.

This document does not constitute or form any part of any offer to sell, allot or issue, or any solicitation of any offer to buy or subscribe for any shares or securities nor shall it, or any part of it, form the basis of, or be relied on in connection with any contract or commitment whatsoever.

Openwell is not acting on behalf of any recipient or reader of this document, and will not be responsible to any such person for providing the protections afforded to its customers or for advising any such person in connection with any matter referred to in this document. The recipient or reader of this document shall be solely responsible for evaluating the merits and risks involved in any investment that may be described in this document.

The information in this document or on which the document is based has been obtained from sources that Openwell believes to be reliable and accurate. Views and opinions expressed in this document are those of Openwell, and are honestly held based on reasonable belief. Openwell makes no representation or warranty, express or implied, as to the accuracy, completeness or fairness of the information and opinions contained in this document, and no reliance should be placed on such information or opinions. The information and views given in this document are subject to change without notice and may not contain all material information concerning the matters referred to.

Openwell may, from time to time: (i) undertake transactions (as principal or agent) in securities referred to in this document and has or may have a position or holding in such securities, or a related investment, as a result of such activities; and/or (ii) provide or have provided services to companies that are referred to in this document.

To the extent permitted by law or regulation, none of Openwell and/or its members, officers, directors, employees or representatives accepts any liability whatsoever for any loss howsoever arising, directly or indirectly, from any use of this document or its contents or otherwise arising in connection therein.
1) What is Social Impact?

All discussion on impact investing must start with a tightly defined interpretation of social impact. We begin by looking at several definitions to draw out the key themes.

The OECD states:

‘Social Impact Investment is a transaction between an investor and investee in a social area, targeting beneficiaries in need. Beneficiaries targeted should be at risk populations and the good provided should have a mix of public and private good characteristics. These transactions are often made using intermediaries. The investee in the transaction should, at least, inscribe a compulsory reporting clause of its social activity in the statutes, as well as provide a formal evaluation of social impact. In parallel, the investor should, at least, have a compulsory reporting clause for social impact investments and have return expectations above or equal to zero, but not above the market rate of return (actual return may be higher).”

This definition provides 4 key conditions for social impact:

1) The investee should be in a social area, targeting beneficiaries in need.

2) The investee should be reporting and evaluating its social impact.

3) The investor should report the social impact of its investments.

4) The investor should have market expectations between zero and the market rate of return.

The first condition is an obvious underpinning of any discussion of social impact. The whole sector is focused upon benefiting society, and so this is the core condition. The second and third conditions become important when we look at social impact specifically in the investment sphere. Measurement and reporting allow us to move from a vague discussion of a concept to having tangible data, allowing investors to judge both the expected financial and social outcomes of an investment. Mandatory measurement and evaluation also allow investors to confirm that the investee is genuinely committed

1 PSS, OECD. Social Impact Investment: Building the Evidence Base
to social impact, rather than simply paying it lip-service. The fourth condition is more problematic, and will be discussed in section 1.1.

The Global Impact Investing Network (GIIN) say impact investments are ‘investments made into companies, organizations, and funds with the intention to generate social and environmental impact alongside a financial return.’ They add the following core characteristics:

1) **Intentionality** – Investor intends to generate the impact.

2) **Investment with return expectations** – Investments are expected to generate a financial return on capital.

3) **Range of return expectations and asset classes** – Expected returns can range from below market to risk-adjusted market rate.

4) **Impact measurement** – Investor measures and reports the social impact and progress of investments.

We can see that these conditions are very similar. The only addition to the OECD conditions is that of explicit intentionality. This is a key characteristic of an impact investment, separating it from an investment by a socially neutral investor that just happens to have positive externalities.

### 1.1) Expected Return Greater than the Market Rate

The condition that the expected return on investment cannot be greater than the risk-adjusted market rate is problematic. The OECD defend it by arguing:

‘Investors expecting a return above risk adjusted market rates indicate that they regard such an investment to be no different from a mainstream for-profit investment and therefore it should fall outside the scope of [social impact investing].’

This could be seen as a problem of overdetermination. Where the expected return on investment is greater than the rate for a for-profit investment, there is sufficient reason to invest in the company even apart from the social impact it provides. This means that it can be unclear whether an investor is investing with a social impact intention or purely from the financial motive.

---

2 PI, GIIN. GIIN Annual Impact Investor Survey
3 GIIN and JP Morgan. Spotlight on the Market
4 Condition 4 for the OECD and 3 for the GIIN.
5 P55, OECD. Social Impact Investment: Building the Evidence Base
6 Where there are two or more sufficient reasons for a particular action.
Such an argument seems counterintuitive when considering the goals of social impact: if the investee company has significant social benefits, then the fact that it is an attractive investment proposition independently of its impact should not be immediately problematic for us. We can maintain our intention to benefit society even where there are other reasons to invest. Moreover, such a way of defining social impact investing would have the effect of excluding some of the most innovative and exciting investments from our scope: those companies that aim to benefit society and have high expected financial returns are often those that have the ability to shift an entire sector.

Indeed, Omidyar Network’s *Priming the Pump* talks about these sorts of companies as ‘homeruns’, arguing ‘everyone loves to invest in the occasional impact investing ‘homerun’ that promises strong financial and social returns—and these homeruns have an important demonstration effect for the viability of the industry as a whole.’ The fact that investors should also be looking at investee companies that aren’t ‘homeruns’ does not undermine the importance of investing in the ‘homeruns’ themselves, as the success of these companies provides inspiration within the sector.

A Bridges Ventures report into impact investment suggests that there is a common trend of impact investing funds demonstrating the viability of a particular type of impact investment, before more conventional funds follow with their own capital. They claim: ‘As more impact-oriented funds demonstrate market rate returns made from high-impact platforms, more institutional funds will look to invest in this sector. This will attract more funds to be raised, increasing the social impact that can be achieved.’ This process shows the potential multiplicative effects of investment in the right impact areas.

---

7 P5, Matt Bannick and Paula Goldman. *Priming the Pump*
8 P12, Bridges Ventures. *Investing for Impact: Case Studies Across Asset Classes*
2) Challenges

2.1) Additionality

The most significant theoretical challenge to impact investment is through the concept of additionality. Paul Brest and Kelly Born focus on this when setting out the impact of an investment:

‘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. With this core concept in mind, we define the practice of “impact investing” capacious, as actively placing capital in enterprises that generate social or environmental goods, services, or ancillary benefits (such as creating jobs), with expected financial returns ranging from the highly concessionary to above market.’

This concept is crucial in ensuring that investments have the maximum impact. That is, impact investors should not just look for investee companies that are benefiting the world, but for companies where their investment makes a significant difference in the provision of this benefit. This notion brings about a counterfactual measurement: what would happen to the company if they had not invested their money in it? The idealised investment is one where the impact investor brings about a positive outcome that would otherwise not arise.

This would be a stronger argument for saying that investing in a company with expected returns above the market rate may not be as impactful: it becomes harder to provide the additionality that comes to define impact investment where the investee company is attractive to socially neutral investors. If a company is about to receive investment of all the capital it requires from a socially neutral investor, it could be wasteful for an impact investor to simply elbow them out of the way and invest themselves, pushing them towards an investment that is not so socially beneficial. In order to invest in a company with high financial returns and still provide a genuine impact, the impact investor must provide some added benefit to the company that they would not have received from a socially neutral investor.

---

9 Brest and Born. Unpacking the Impact
10 Investors that lack a social impact focus.
2.2) Information

Cathy Clark and Ben Thornley argue that there is ‘ongoing difficulty for investors to navigate impact investing easily and efficiently.’\(^{11}\) Included in the reasons for this are a ‘lack of agreed-upon product categories and underdeveloped performance benchmarks.’\(^{12}\) Such an informational deficit can have serious effects, which they divide into four main groups:

1) Slow entry. ‘Barclays recently reported that, while more than half its clients are interested in impact investing, just 9 percent had actively engaged for lack of ‘knowledge, guidelines, or frameworks.’’

2) Inefficient market matching.

3) Inappropriate impact expectations. There is an ‘absence of frames that clearly establish appropriate objectives.’

4) Market gaps. The current market provides too little visibility into where capital might be most needed, leading to a lack of appropriate investment across the risk/return spectrum (the challenge identified by practitioners as most limiting to the growth of impact investing).

It seems clear that these are the sorts of challenges impact investment funds should be addressing. These are problems that arise because the sector has not yet been properly developed. For any sector to be lacking investment because those operating within it have not been able to set out a clear framework that makes it comprehensible to investors is wasteful; for the social impact sector to be in this position is hugely damaging.

2.3) Products

There are various challenges associated with social impact investment products. A 2012 Rockefeller report outlines a few of these:

‘Placing and managing capital have proven to be more difficult than raising capital. Barriers here have included investor concerns with a lack of exit opportunities, an insufficient menu of products designed for large investors, models of risk assessment that force a trade-off between impact and risk-adjusted financial returns and high transaction costs associated with structuring and executing innovative and untested investments…

---

\(^{11}\) Clark and Thornley. Cracking the Code of Impact Investing

\(^{12}\) Ibid
So far, though, there are relatively few products that enable institutional investors to place and manage capital at scale. The main exceptions to these are the areas of affordable housing and, more recently, microfinance and clean technology.’

These challenges are as follows:

1) Investors are concerned with a lack of exit opportunities.
2) There is an insufficient menu of products designed for large investors.
3) Risk assessment models force a trade-off between impact and risk-adjusted financial returns.
4) High transaction costs associated with structuring and executing innovative and untested investments.
5) Few products allowing capital to be placed and managed at scale.

The GIIN echo the concern with exit opportunities, with their survey showing that ‘the area in which the least number of respondents saw at least some progress was ‘suitable exit options’ and this ranked as the third-greatest challenge overall.'

---

13 Pxiv, E.T. Jackson and Associates Ltd. Accelerating Impact
14 P9, GIIN. GIIN Annual Impact Investor Survey
3) Responses

3.1) Accounting for Additionality: Ensuring Impact

The additionality concern is one that must be accounted for in order to ensure impact. Importantly, the concern only arises in a situation whereby the investee company would have been equally well capitalised and would have had the same impact focus without the impact investor. If the impact investor only invests in companies that are commonly expected to succeed and then does not require anything of the investee company beyond what a socially neutral investor would have required, then the additionality argument holds and the investment is not truly impactful.

This does not mean that impact investment is not possible near or at the double bottom line of high financial and social returns. We present a three-tiered response to the theoretical concern, showing that it is possible to genuinely have a strong impact whilst investing in highly profitable companies.

3.1.1) Expertise

Impact investors tend to focus their attention on the social impact space, giving them a greater attention to detail and awareness of what makes a social impact company successful. Empirical studies of socially responsible investing have shown that it is possible to achieve market\(^5\) or above market\(^6\) rates of return. This suggests one of two things:

1) Impactful companies tend to outperform the market.
2) Impact investors tend to take more care and have more expertise in their investments, and so only invest in the best and most impactful companies or significantly improve their investee companies.

If 1) is true and the market does not price it in, then impact investment can quite easily achieve market rate returns whilst being socially additional. If 2) is true, then the care impact investors take will ensure they maximise market returns for the investee companies, whilst providing financial returns and the requisite social impact additionality.

3.1.2) Shareholder Activism

Investing in social impact companies gives investors the ability to engage in a holistic relationship with them. If impact investors were to find companies that had a marked social impact and could help them

---

15 Revelli, Christophe, and Jean-Laurent Viviani. Financial performance of socially responsible investing (SRI): what have we learned? A meta-analysis.
16 Friede, Gunnar, Timo Busch, and Alexander Bassen. ESG and financial performance: aggregated evidence from more than 2000 empirical studies.
to develop through their expert advice, this would produce a genuine social impact even in cases where they provide rates of return above the market rate.

Moreover, enforcing measurable strict social impact criteria for the investee company would help solidify social impact in a way socially neutral investors would not. This could be achieved by a simple setting of guidelines, but a more secure way of doing so would be through a partnership with an independent social impact assessment and accountability organisation. Having this as a condition of investment partnership with the companies would ensure that they continue to provide a social impact where they might not have done with other investors, and ensures that the investors have no option to compromise on their impact focus.

Crucially, there are two potential outcomes of shareholder activism that would have significant impact:

1) A company with a strong social impact focus will be able to unlock its financial potential and become an attractive proposition to socially neutral investors.

2) A company with strong financial credentials will have its social commitments secured by its partnerships with the investor and a potential third party social impact organisation.

By enforcing social impact metrics, the impact investor ensures that the investee company measures itself on this scale as well as financially. Impact investors can be equipped to provide either a financial or a social framework to an investee company, providing two potential routes for ensuring impact.

3.1.3) Multipliers

Having used expertise both to select and then develop the best socially impactful companies, impact investment can have a strong multiplicative effect. The Michael and Susan Dell Foundation look at the possibility of investing in early stage companies:

\[ \text{In early stages of innovation, commercial capital tends to be scarce. Low-income populations have little money, and their cash flow is irregular. As a result, they're usually ignored by market-based services and solutions. Helping to incubate innovations specifically designed to address these customers' needs, gives us the opportunity to demonstrate proof of concept (as well as the potential for profitability.) Just as importantly, taking an early seat at the table allows impact-first investors to help establish sector norms that adequately balance social and financial ROI—before} \]
commercial capital rushes in to take advantage of the new opportunity.\textsuperscript{17}

Companies at this stage often do not have access to the sort of capital they require from socially neutral investors, and so any investment would fit with additionality. Given the expertise impact investors tend to have in this sector, they would expect to find the companies with the best leadership teams and most viable business plans. This would help achieve above benchmark financial returns, whilst having incredible multiplicative effects.

The multiplicative effects of demonstrating the viability of investment in these sectors is twofold:

1) When the investee company performs strongly, it will receive more investment from socially neutral investors, allowing it to perform even more strongly. And so the cycle goes on.

2) The investee company acts as a signal that a company can be genuinely socially impactful and financially profitable in its sector. This means that there will be both more investee companies setting up and more socially neutral investors willing to invest in these sectors.

The multiplier effect, then, is crucial. It leads to a potential scenario where £1 of impact investment has £100s of social return. Once an investee company in the impact space demonstrates its worth, it goes from being an attractive proposition to an impact investor to being an attractive proposition to anyone. More excitingly, it also serves as a possible sector-shifter, demonstrating the viability of its sector and so providing a huge multiplication in impact.

Indeed, Omidyar Network’s report Priming the Pump focuses on how the best form of providing impact is by investing in an undercapitalised sector. They argue

‘With time, we realized that this insistence on risk-adjusted returns would cause us—and the impact investing industry as a whole—to systematically under-invest in creating the conditions under which innovations—and entire new sectors—could be sparked and scaled.’\textsuperscript{18}

This suggests smaller, early stage companies with high potential are the best companies to invest in in order to ‘prime the pump’ and facilitate explosive growth in social impact sectors. This means that there will be a positive externality in impact investments: each investment will benefit their sector as a whole. For impact investors focusing on a few sectors, each investment should benefit from the externalities of their other investments.

---

\textsuperscript{17} Geeta Goel. Impact investment: The case for early-stage investments
\textsuperscript{18} P6, Matt Bannick and Paula Goldman. Priming the Pump
Moreover, impact investors have the opportunity to establish sector norms that frame the socially neutral investment that will follow. This means that the impact caused by shaping the social impact focus of the investee company could define how future companies in the sector aim to create impact.

3.2) Response to Information Challenge: Define Methods of Measurement and Accountability

Partnerships with independent social impact assessment and accountability companies and innovative fund structures can provide impact funds with the opportunity to make social impact a measured outcome that can be easily understood in the same way as financial returns are understood now. When a lack of comprehension of the social impact space holds back many potential investors, these systems could be ground-breaking. By setting out hard metrics of social impact, impact investors can ensure that the sphere is not one of hand-waving and grand intentions, but of tangible, positive results. It is not enough to know that there is some positive externality: it should be measured, demonstrated and analysed.

3.2.1) The Effective Altruism Method

The Effective Altruism movement in the charity sector provides us with an indication of how we can make impact more quantifiable. They are strictly centred on the notion of additionality: Will MacAskill argues that it could be better to take a high paying job and donate half of your income to effective causes than to work for a charity. This is because if you get a job in a charity, you are likely displacing somebody similarly qualified and impact-driven. If you get a high paying job, you are likely displacing somebody who will do less good with their income than you would. 19 While there may be other considerations in such cases, the strict focus on the quantifiable good is an important lesson that should be carried from their analysis of charities to our analysis of impact investment.

Effective altruists focus on maximising the marginal benefit of a dollar’s investment. This means, in many cases, it is more beneficial to focus on prevention rather than cure. One metric used is Disability-Adjusted-Life-Years (DALYs): ‘One DALY could equal one year lost to early death, 1.67 years of blindness, or 41.67 years suffering stomach pain from an intestinal parasite. If a program has averted 80 DALYs, it might have saved the death of one infant or cured minor health problems for several adults.’ 20 This sort of metric makes it easier to measure the impact of a healthcare initiative and provides us with more information about the social value of an investment.

Reducing value to numbers cannot be done easily for some issues: trying to measure the value of women’s rights purely in economic terms would miss the point, for example. The Effective Altruism space has shown that there are many cases where a more quantifiable method would have a direct

---

19 Derek Thompson. The Greatest Good
20 Ibid
impact on the world, however. For instance, Effective Altruists recommend donating to the Deworm the World Initiative, which started following Michael Kremer and Rachel Glennerster’s randomised control trials that showed that treating intestinal worms in children was far more effective for school attendance than ‘textbooks, flip charts or smaller class sizes.’ These sorts of results are hugely informative and ensuring that such things are regularly measured and reported would erode the informational problems that act as a barrier to entry for many investors.

These methods can be highly informative in our search for finding more effective ways of analysing social impact. Where outcomes can be broken down into quantifiable data – in healthcare, for example – this data should be produced and examined much like financial outcomes are. Once the social value of investment in different sectors becomes clear, detailed study into the distribution of capital across the space, like that being done by the GIIN, will be crucial for providing investors with the understanding of the financial element.

3.3) Response to Products Challenge

The lack of exit opportunities is clearly a significant challenge within this space. The most effective way of solving it is through the multiplier effects described in section 3.1.3. If investee companies have demonstrative success, this will lead both to increased demand for the company and demand for the sector as a whole. This is clear when we look at the current growth within the impact investing industry: Rod Schwartz, CEO of ClearlySo cites growth estimates of 30-40% within the UK market and the 2016 GIIN survey’s respondents planned to increase capital committed by 16% and number of deals by 55% in the next year.

The remainder of the challenges raised in this section all face a similar solution: as the impact industry grows and its viability is demonstrated both to investors and potential investee companies, the menu of products will increase, the trade-off will not be perceived in the same way, there will be more products allowing capital to be placed and managed at scale, and the transaction costs won’t be as high.

Indeed, Social Impact Funds that particularly focus on scalable solutions to important problems will significantly act to address challenges 2) and 5), and will have the demonstrative effects mentioned earlier to help with 3).

These challenges will not have quick fixes, and present genuine concerns to investors. With collective action to grow the impact investment space in an intelligent and targeted way, the menu of products will improve and the number of investors will increase, and so the medium term promises solutions.

21 Ibid
22 Salt. Rod Schwartz: The future of impact investing
23PX, GIIN. GIIN Annual Impact Investor Survey
Social Impact Investing: Challenges and Opportunities
4) Opportunities

The challenges in section 2) provide significant opportunity for those looking to invest in the impact space. There are also opportunities that cannot be classed as a simple response to a challenge.

4.1) Making Social Impact Mainstream

One of the most valuable things impact investors can do when they invest in a company is make their own roles as impact investors in that sector obsolete. If they can use their expertise, contacts and careful analysis to select the right companies in the social impact space, they will be able to invest in companies that show eye-catching growth. When we look at the effect the Gates Foundation had on a company like bKash and the mobile banking industry in the developing world, we can see that investing in the right company in these sectors is far more impactful than just the direct returns on investment. Demonstrating that these companies can be successful has three potential effects:

1) Increases the investment from socially neutral investors in the investee company.
2) Increases the number of start-up companies in these sectors.
3) Increases the investment from socially neutral investors in the sector as a whole.

This is a phenomenal opportunity to show the viability of companies in the social impact space and make it part of the mainstream, rather than an investment taken on by specific impact investors or an offshoot of a larger investment company as part of a diversification project. The social and financial demand in many sectors is overlapping, and we can demonstrate that.

4.2) A Greater Understanding of Additionality and Impact

Understanding exactly what it is for an investment to be impactful is difficult, especially when it relies on understanding counterfactual situations and projecting those outcomes. Having a genuinely positive impact is not as simple as just investing in companies that are doing good things, and sometimes profit may have to drop to slightly below market rate in order to truly achieve social impact. In order to maximise impact, it is important to be more than just an investor: partnership and shareholder activism is crucial in ensuring that the company is able to achieve social impact it would otherwise not have achieved. There is room for further scholarship in this debate and our understanding of what it means to be truly impactful can only develop.

24 Greg Chen. bKash Bangladesh: What Explains its Fast Start?
4.3) New Fund Structures and Partnerships

Traditional fund structures incentivise fund managers solely through financial return. A 2 and 20 fund returns model is standard across the industry. A number of innovative funds have contemplated impact returns-based carry incentives for fund managers. In this instance, fund managers would receive a delta on the typical 20% carry, depending on the annual achievement of impact KPIs. If the investment is a financial homerun, with little social impact, fund managers receive a lower, (say) 15% carry on a higher exit multiple. The 5% delta in this example should be allocated through an effective altruism framework. Linking carry to social impact aligns investors with fund managers and provides measurable financial and social returns for the investor. In order for the impact KPIs to be effective, there is a requirement to assign an independent impact assessor to set, monitor and report on impact KPIs. If the fund itself set KPIs, there would be little incentive to set stretch KPI targets.

Traditional investment structures offer performance-related incentives to founders; share options will be converted if certain financial and operational KPIs are met. A social impact fund that uses an independent organisation to set and monitor impact KPIs can easily link successful fulfilment of impact KPIs to share option conversion.

The utilisation of independent impact assessment, monitoring and accountability allows for true investor, fund and founder alignment, allowing for a sophisticated social and financial returns analysis on a portfolio basis.

4.4) Millennial and Gen Z Commitment to Social Impact

A significant proportion of young workers are passionate about social impact, with a 2016 Deloitte survey finding that ‘56 percent of Millennials have “ruled out ever working for a particular organization because of its values or standard of conduct”’ 25 and ‘(87 percent) believe that “the success of a business should be measured in terms of more than just its financial performance.”’ 26

These traits are repeated in the so-called Generation Z, scaling young people between the ages of 15-20. A recent Nielsen global online study found:

‘[Members of Generation Z] are willing to pay extra for sustainable offerings—almost three-out-of-four respondents in the latest findings, up from approximately half in 2014.

The rise in the percentage of respondents aged 15 - 20, also known as Generation Z, who are willing to pay more for

---

25 P11, Deloitte. The 2016 Deloitte Millennial Survey
26 P9, Ibid
products and services that come from companies who are committed to positive social and environmental impact was also strong—up from 55% in 2014 to 72% in 2015.”

These numbers suggest an increasing focus on social impact, improving the talent within the sector and potentially making the quality of deal flow more pronounced. These significant trends suggest that the social impact space has the potential to access an increasingly wide market and that the multiplier effects and sector shaping discussed in this paper will have real importance.

27 Nielsen. Green Generation: Millennials say Sustainability is a Shopping Priority
5) Summary

Social impact as defined by the OECD and GIIN is too limited to fully capture the nuance within the space. Although the concept of additionality should always be at the heart of impact investment for the investment to be genuinely beneficial, it is possible to achieve significant social impact whilst making above market rate financial returns. Indeed, at this early stage in its life, the social impact space is full of opportunity for sector formation and multiplication effects that can make the social and financial return on investment significant.

More research is required in this field to develop the knowledge base. The discussion about a potential conflict between the double bottom line and additionality is a live one and needs to be fully understood to properly inform impact investors. It is worth noting that concessionary investment in impactful companies will definitely provide additionality – and therefore impact – but when judging the benefits of such investment it is important to consider the quantity of the concession to be equivalent to a grant and evaluate it as such.

More research also needs to be done in understanding the Effective Altruism method and having strict quantitative criteria for impact. While some values are difficult to place metrics on, there are lots of areas where we could have a much easier understanding of the impact of investment. Properly understanding the effect of healthcare investment on DALYs would be one way of improving our measurement of social impact, making decisions clearer for investors and showing that social returns are not intangibles that we talk about in hope rather than expectation.

To summarise, in order to make an impact, investors must:

1) Provide more to investee companies than the socially neutral investor would.
2) Hold investees to account for measurable social impact.
3) Improve the financial returns of investee companies to help them grow, attract more investment, and demonstrate the viability of their sectors.
4) Be actively aware of additionality.
5) Look for opportunities to shift socially neutral capital to neglected socially impactful sectors, whilst setting the norms in those sectors.

There are two ways for them to achieve the double bottom line and make a genuine social impact:

1) Helping a company with a strong social impact focus to unlock its financial potential and become an attractive proposition to socially neutral investors.
2) Helping a company with strong financial credentials to secure its social impact credentials through partnerships with the investor and a potential third party social impact organisation.

We are at the edge of a social impact investment precipice where attention, money and sophistication focused in the right way will shape a sector that has a genuine ability to shift to the mainstream, providing huge financial and social returns.
Social Impact Investing: Challenges and Opportunities
6) About Openwell

Openwell is a social innovation firm. We exist so that world-changing ideas can reach their full potential. We support creators and innovators, turning ideas into reality, providing consultancy and access to capital so that our clients can do more good in the world. Established in 2012, Openwell combines expertise from multiple sectors: business, finance and charity. We work with multi-nationals, funds, philanthropic institutions and major charities - a diverse client list with the common desire to do more good. For more information on Openwell, please visit our website www.openwell.co.

Openwell is in the process of launching a Social Impact Fund that marries the theoretical guidelines of this report with the practical research completed in its sister report; The Current State of Social Impact. The fund will invest in early stage social impact companies and seeks to attract Impact Investors to fulfil a GBP7.5m target fund size. We have partnered with the Social Stock Exchange to provide high quality, independent impact assessment, resulting in true investor-fund-founder alignment through social impact-derived Carry and Founder Share Option incentives. For more information please contact stephenbarnett@openwell.co.
7) About the Authors

Stephen Barnett, Partner

Stephen became a partner at Openwell after positions held with HSBC and BP, in both London and New York. As a Social Sciences graduate from Cambridge, Stephen is passionate about applying the methodologies and intellectual frameworks witnessed in Social Sciences to early stage investing. Stephen has invested and supported a number of early stage startups and is the founder of Catalyst Founders, which seeks to invest in, support, and nurture young founders under the age of 24. As a partner, Stephen has been responsible for launching Oxford’s newest shared workspace, Openworks, developing frameworks for effective giving in Europe and helping to design an effective, impactful developing country school model.

Ihsaan Faisal, Analyst

Ihsaan is a Masters student in philosophy at the University of Oxford. He graduated with a First Class Honours degree in PPE from Oxford, spending his degree focused on philosophy and economics, and has a keen interest in the overlap between the areas. In particular, Ihsaan is focused on understanding the most effective ways of driving social change and is bringing this to his internship at Openwell, a company that works in the social impact space and shares his focus.
Bibliography


Social Impact Investing: Challenges and Opportunities

www.openwell.co

contact@openwell.co