Impact Investment:
After 15 years of hype, what has actually changed?

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Bringing impact to investment.

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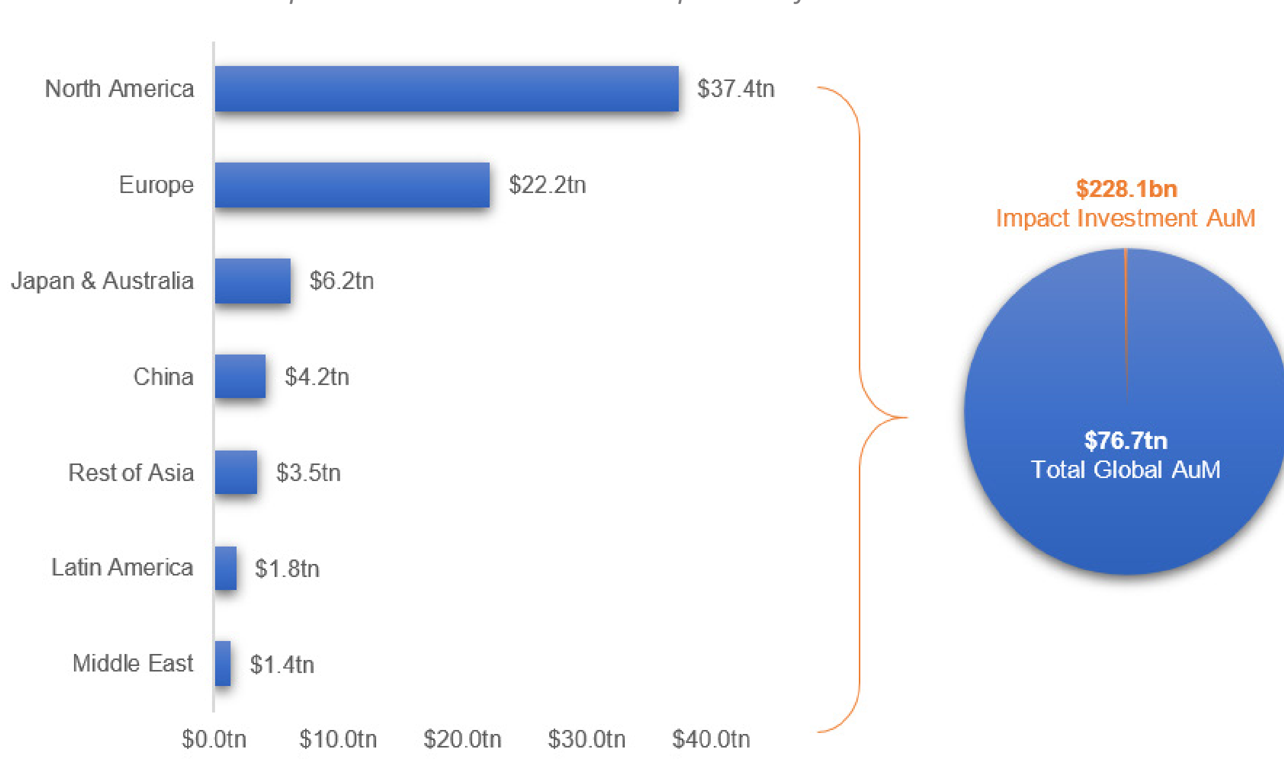
Introduction

Over the past fifteen years, the concept once known as 'social enterprise and investment', and now more commonly described as 'impact investment', has been subject to a considerable amount of hype. Despite the many articles, well-attended conferences and governmental pronouncements, many observers continue to question the relevance and importance of this movement. The truth is that the impact investment sector, despite first emerging as an investment theme in the 1970s, remains a very small part of the professional asset management industry. According to the Global Impact Investment Network ("GIIN"), there were $228.1bn of impact investment assets under management by the end of 2017.[i] As the chart below suggests, this was considerably less than 1% (approximately 0.3%) of global assets under professional management at the time.[ii]

Impact Investment AuM as a Proportion of Global AuM in 2017[iii]

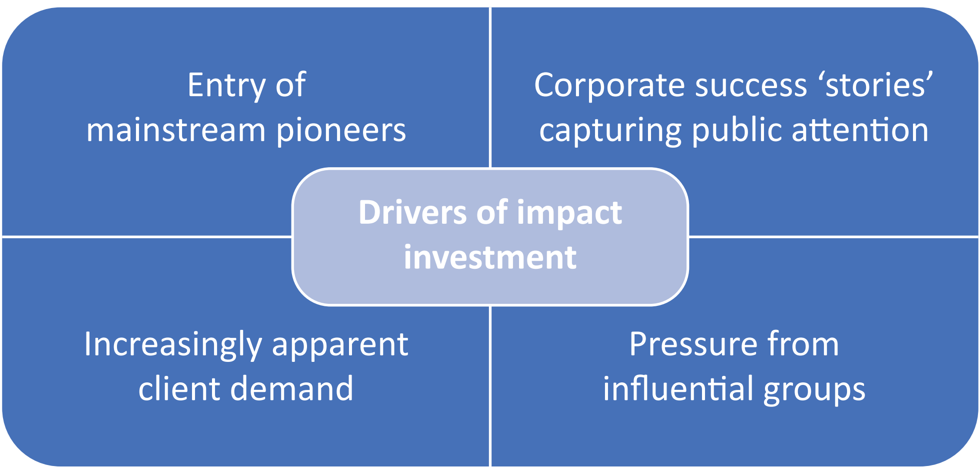


Nevertheless, the theme of impact investment appears to be gaining momentum, with an ever-increasing number of investors, asset managers, and professionals looking to develop impact investment strategies. With this in mind and largely for the benefit of guests at the UK's first ever impact investment funds conference organised by ClearlySo,[1] we felt it appropriate to briefly assess the historical background of the movement and to comment on its recent trends. We aim to offer a point of view regarding the sector's prospects for future growth.

In summary, while the idea of incorporating values into financial investments has been in existence since the 1970s, it only really started to gain tangible traction on a global scale at the turn of the new millennium. The

1 An afternoon of discussion on 17th January 2019, exploring impact investment funds and why there may be no time like the present to get involved. Guest speakers include Octopus (Note: Octopus is a shareholder of ClearlySo), AXA Investment Managers, Palatine Private Equity, Kempen Capital Management and more. https://www.clearlyso.com/clearlyso-impact-investment-funds-conference-2019/

UK has been a pioneer in the impact investment space,[2] with heavy government encouragement and subsidy for its development. Ironically, although unsurprisingly with hindsight, while the former (i.e. government encouragement) may have been initially beneficial to the sector's growth, it is possible that the high levels of subsidy and intervention could have in fact impeded its development, as large state-assisted or specifically created institutions undermined wider private sector development, especially among UK financial institutions. As the focus of central government funding continues to shift onto other priorities, it seems as if the private sector, in the UK and across the globe, has become more active in its consideration of impact investment. It is this trend which appears to be likely to support, or even to accelerate, the global growth in this area. At ClearlySo, we believe that this momentum is being driven by the following key market dynamics:



We will discuss each of these drivers in further detail but, for the benefit of those readers less familiar with the background of the impact investment movement, we will briefly summarise its history and elaborate on both the nature and eventual consequences of the aforementioned governmental intervention.

2 In fact, many suggest that the UK led the rest of the world's adoption and uptake of this phenomenon – a view also shared by ClearlySo

Historical background

From the foundations of the first ethical unit trust, The Body Shop in the UK and Ben & Jerry's in the US, it is widely accepted that the first generation of impactful entrepreneurs was born out of the 1970s. It was these individuals – Charles Jacob (first ethical trust), Anita and Gordon Roddick (The Body Shop), Ben Cohen and Jerry Greenfield (Ben & Jerry's) – that pioneered the concept of positioning ethical and social considerations at the heart of a business's product offering without the need of sacrificing corporate growth or commercial success.

This phenomenon coincided with a wider sense of social consciousness that had started to permeate throughout the UK in the 1980s – influenced by the oppression of apartheid in South Africa and a growing awakening regarding environmental issues – and ultimately resulted in the birth of the Socially Responsible Investing movement ("SRI"). In 1984, life insurer Friends Provident established the UK's first fund to incorporate ethical principles at the core of its investment criteria.[3] Within 15 years of the launch of this Stewardship Fund, retail SRI assets under management in the UK[4] had grown to £2.4bn.[iv] The exponential growth in SRI was largely supported by changes in UK law which required occupational pension schemes to declare any social, environmental or ethical factors in their investment decisions. In stark contrast to this, the impact investment sector continued to develop "in relative isolation, without high recognition or engagement from the bulk of mainstream investors".[v]

In 2000, the Labour Government launched the Social Investment Task Force ("SITF") with the aim of addressing what it considered to be an evidently malfunctioning market. The SITF's specific remit was to "set out how entrepreneurial practices could be applied to obtain higher social and financial returns from social investment, to harness new talents and skills, to address economic regeneration and to unleash new sources of private and institutional investment".[vi] This led to a wave of ground-breaking and innovative initiatives (mostly government led) throughout the first 15 years of the new millennium. There was a palpable sense of optimism – the promise of a new dawn for the impact investment sector to be delivered through the likes of the below:

UnLtd, the foundation for social entrepreneurs, was founded in 2001 through a permanent endowment of £100m from the Millennium Commission.[vii] The organisation funds and supports entrepreneurs in the belief that they can contribute significantly to both the economy and society. UnLtd has "had an enormous impact on the growth of social entrepreneurship across the UK",[viii] creating 25,597 jobs and helping 571 social enterprises to launch in 2016/2017 alone.[ix]
Webpage: https://www.unltd.org.uk/

3 The first ever publicly available mutual fund to consider both social and financial criteria within its investment decision process was launched in the US in 1971 (Pax World Balanced Fund with approximately £100k of AuM)
4 According to Triodos Bank, SRI assets in the UK currently account for approximately £17bn and are forecast to grow to £48bn by 2027 (Triodos Bank)

In 2002, the government provided £20m of matching investment on a first-loss basis to launch Bridges Ventures,[x] the first community development venture capital fund in the UK, which played an important role in showcasing the "impact-driven investment approach"[xi] to mainstream investors.
Webpage: http://www.bridgesfundmanagement.com/

In 2004, the government funded the launch of Futurebuilders – a fund aimed at strengthening the impact sector's role in public service delivery.[xii] In 2008, the Social Investment Business won the bid to retender and manage the Futurebuilders fund.[xiii]
Webpage: https://www.sibgroup.org.uk/futurebuilders-england

Social Finance Ltd, a not-for-profit intermediary organisation, founded in 2007 with £1.3m of initial capital seeded by a group of 5 philanthropists.[xiv] Established with the aim of supporting and facilitating the flow of capital to new models of social change, Social Finance would ultimately be responsible for the first Social Impact Bond in 2010 (designed to work with 3,000 male, short-sentence prisoners leaving Peterborough Prison).[xv]
Webpage: https://www.socialfinance.org.uk/

The Dormant Bank and Building Society Accounts Act was passed through government in November 2008.[xvi] Essentially the origins of Big Society Capital,[5] the newly legitimised collection and redistribution of unclaimed bank and building society accounts across the UK would be transformational in introducing a new source of much needed capital and professional support into the impact investment market.
Webpage: https://www.bigsocietycapital.com/

On the back of such ambitious initiatives, it is possible to see why the UK was widely regarded as the leading force at the forefront of innovation within the global impact investment sector. The following illustration, sourced from the UK National Advisory Board report '*Building a Social Impact Investment Market – The UK Experience*', provides a detailed timeline of the key developments that occurred in the UK impact investment market between 2000 and 2014.

5 Note: Big Society Capital is a debtholder and shareholder in ClearlySo

Key developments in the UK Impact Investment Market[xvii]

2000

Social Investment Taskforce
Independent body launched by HM Treasury

2001

UnLtd
First social enterprise incubator / accelerator

2002

Bridges Ventures
First fund focused on community investment with matching capital

Community Investment Tax Relief
Tax relief for community investment through CDFIs

Charity Bank
First bank in UK devoted to servicing charities

Community Development Finance Association
Trade association for CDFIs launched to drive the market growth

2003

2004

Futurebuilders
Home Office launches first programme targeted at lending to social enterprises

Community Interest Company
Specific legal form for social enterprises or mutuals

2005

2006

2007

Social Finance
Key intermediary to act as advisory party to commissioners and organisations

2008

Dormant Accounts Bank
Preceded by the Commission on Unclaimed Assets

2009

2010

First Social Impact Bond
Peterborough SIB launched by Social Finance with MOJ and diverse investors

2011

DWP Innovation Fund
First fund to drive innovation to address NEETs through commissioning of multiples interventions

Scope Charity Bond
Scope launches £2m charity bond as part of broader programme

2012

Investment & Contract Readiness Fund
First fund to support the readiness of social enterprise to take investment and receive contracts

Big Society Capital
First wholesale social investment institution

Social Outcomes Fund
Cabinet Office launches cross-Government fund to help spur departments and commissioners to develop social impact bonds and spur savings

Community Shares Unit
Institution to gather best practice, monitor and promote community share offers

Social Value Act
Legislation to embed social value in procurement processes across Government

2013

What Works Centres
Centres to collect evidence for policy-making

2014

Unit Cost Database
Open data provides information on costs of certain social outcomes

Social Investment Tax Relief
First investor-based tax relief targeted at social investments

Investment Intermediaries Fiduciary Duties Reform
Law Commission consultation on fiduciary duties of investment intermediaries (and pension funds)

UK Social Bond Fund
Threadneedle with Big Issue Invest launch fund that individual investors can invest into (corner-stoned by Big Society Capital)

Government intervention: a possible deterrent to private sector investment

Despite the initial efforts to establish a galvanised impact investment sector, the size of the market remained microscopic in contrast to mainstream capital markets. As at the end of 2015, impact investment in the UK was estimated to be worth £1.5bn;[6] the equivalent to less than 0.1% of professionally managed assets under management in the UK alone which had reached £5.7tn that same year.[xviii] Note that this proportion is even less than the global equivalent of 0.3% as indicated on page 4.

It is probably not an overstatement to suggest that the state of the impact investment sector had significantly underachieved the lofty expectations that had been envisioned for it at the turn of the century. By 2015 – so 5 years after the end of the SITF's initial mandate – the impact investment sector had only managed to 'unlock' 27.3% of the £5.5bn financing target that the same governmental body had set in its preliminary vision for a functional impact investment market place by 2010.[xix] The sector was even under-performing relative to more contemporary forecasts, with the impact investment deal flow in 2015 delivering £427m of transactions in comparison to BCG's £750m estimation.[xx]

While the government may have been correct to focus on the three key factors necessary to build the impact investment market (supply, intermediary, demand – see below),[xxi] it was possibly its flawed approach to the first of these three "mutually supportive and interdependent"[xxii] market elements (i.e. the 'supply' side) that would ultimately consign the sector to a period of disappointing growth and a failure to live up to its intended promise.

Segmentation of the UK Impact Investment Market[xxiii]

	Market Elements		
	Supply	Intermediary	Demand
Market Sub-segments	Individual investors	Social banks	Co-operatives*
	Institutional investors	Fund managers	Charities*
	Government investment	CDFIs	Social enterprises*
	Charitable foundations	Infrastructure	Mainstream business
	Philanthropists	Instruments	Government commissioning
	Corporates		

* Social organisations

According to SITF data, the vast majority of funding into the impact investment sector between 2000 and 2010 was in the form of government grants. While SITF estimates of approximately £350m[7] have been widely referred to as the amount of public money invested into "social entrepreneurship, charity capacity building and other support for social ventures"[xxiv] during the task force's inital mandate, ClearlySo considers the full extent of government sanctioned funding to have been well over £1bn. The SITF estimation consists of the £100m endowment offered to UnLtd in 2001, £42m to support the launch of Community Development

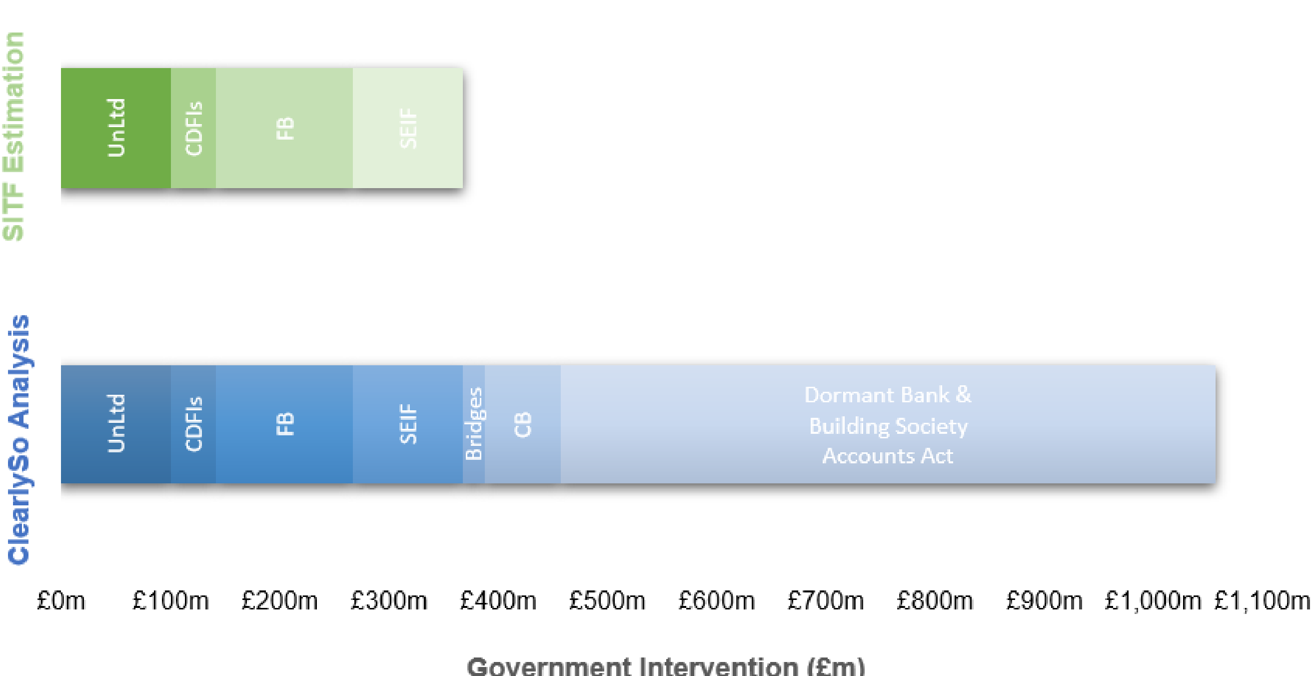
6 70% of which represented social investment backed by some sort of asset lock. This total was spread across 3,463 investments
7 Note: as reported in the Social Investment Task Force (2010) 'Social Investment Ten Years On'

Finance Institutions (CDFI) in 2003, £125m for Futurebuilders in 2004 and £100m towards the establishment of the Department of Health Social Enterprise Innovation Fund in 2009.[xxv]

ClearlySo, on the other hand, calculates that the SITF approximation does not fully account for a number of additional government funded or supported initiatives. This includes the £20m of matching investment to create Bridges Ventures in 2002,[xxvi] the £215m originally allocated to Futurebuilders,[xxvii] the £70m contribution towards the Communitybuilders Fund in 2008,[xxviii] and – most significantly of all – the £600m that would eventually be allocated to Big Society Capital ("BSC") in the government's attempt to "help grow a culture of social investment".[xxix]

Some observers may contest the inclusion of BSC's allocation in this analysis due to its official launch falling outside of the SITF's initial mandate (i.e. April 2012), as well as the fact that the funding was not directly government sourced. However, it is important to note that the basis of its foundation, the Dormant Bank and Building Society Accounts Act – which eventually required banks to pass over £400m of dormant account assets to BSC – was approved by Parliament in November 2008. In addition to this, we believe that governmental pressure played a key role in influencing the UK's largest high street banks to invest a further £200m into BSC. Both of these considerations lead us to conclude that the full £600m[8] allocation to BSC ought to be included in the estimation of state support for the impact investment sector.

Government Intervention into the Impact Investment Sector from 2000 to 2010[9]



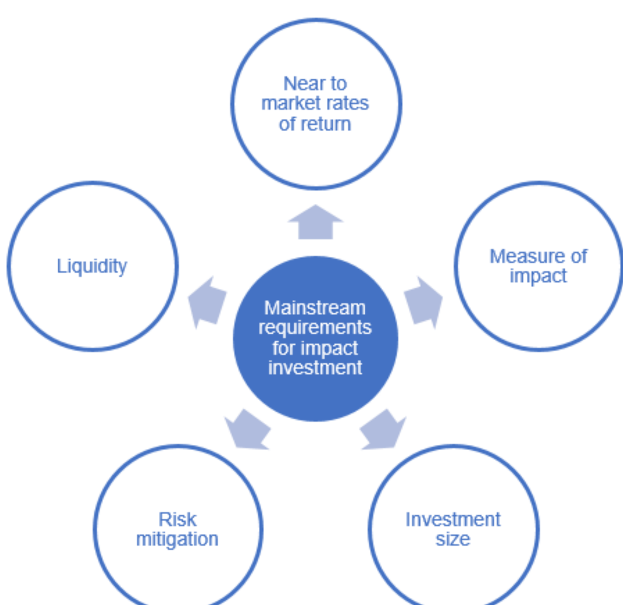
8 The £600m allocated to Big Society Capital in 2012 consisted of £400m of unclaimed cash left dormant in UK bank accounts for over 15 years and a £200m investment from the UK's four largest high street banks Barclays, Lloyds, HSBC and RBS

9 Note: FB (Futurebuilders) and CB (Communitybuilders Fund)

By offering finance to the value of over £1bn through a host of associated funds, the government's role as an impact financier "dwarfed all other players combined".[10] In doing so, ClearlySo believes that the government may have flooded the market with a pool of public money which may have had the perverse effect of discouraging potential mainstream players with a more commercial approach.

Indeed, it is rather ironic that the SITF stated in its final report dated April 2010 that a "vibrant social investment market" would depend on the "active participation of a wide variety of investors",[xxx] which itself would require "investor access to a range of well-structured investments".[xxxi] Quite possibly, the very nature of the government's capital – namely grant funding to support high risk entities that did not normally qualify for bank or other mainstream financing – may have distorted available returns.[11] It may have also undermined the creation of commercially recognisable investment products capable of satisfying the "commonly identified requirements"[xxxii] of private and institutional investors (as illustrated below) and a proven track record from which to gain confidence.

The 'Commonly Identified Requirements' for Mainstream Investor Engagement in Impact Investment[xxxiii]



While there is some argument to suggest that the influx of government funds could have beneficially incentivised impact enterprises, with Warwick Business School indicating that 71% of such entities sought grant support in comparison to only 6% of mainstream businesses,[xxxiv] a potential failure of this grant-based system was perhaps its inability to equip impact entrepreneurs with the financial skill set necessary to attract the interest and confidence of mainstream investors. To quote the 2012 report '*Investment Readiness in the UK*', the funding of grants should have been provided "with great caution, with appropriate funding

10 Note that the two largest non-governmental social funds in 2010 were the charitable foundations of Esmée Fairbairn and Venturesome, neither of which held more than £20m of financial commitments at the time

11 According to BCG, market critics believed that Futurebuilders "created unrealistic expectations about the cost of lending" to the impact sector and represented "a distortive influence that undercut other nascent players to get funds out of the door" (BCG: A Tale of Two Funds – The management and performance of Futurebuilders England)

mix, in collaboration with investors" to ensure that any such commitments were capable of maximising the "entrepreneurial potential of the grantee".[xxxv]

In fact, this point raises the question of whether resources could have been more appropriately focused on developing the second of the SITF's initial recommendations – the provision of matching finance to help set up community development venture capital funds. Given the eventual success of Bridges Ventures, whose initial government matching investment of £20m "led to over £120m of private-sector investment" in follow-on Bridges funds by 2010,[xxxvi] there is scope to believe that this financing model could have been a more suitable policy through which to help prepare impactful enterprises in their path to investment, i.e. by bridging the gap to mainstream investors. The financial performance of Bridges Venture Funds I and II, which has been described as positive, certainly played an important role in awakening the mainstream to the compatibility between impact and market level returns.

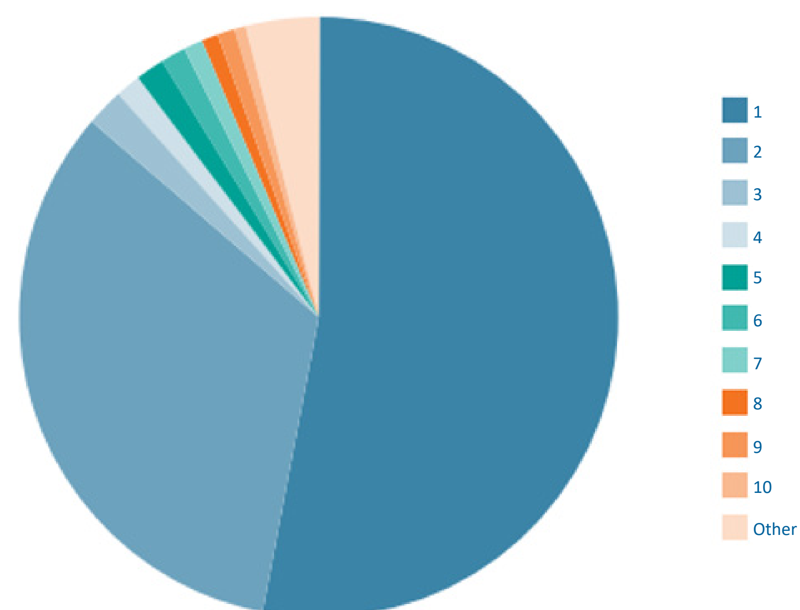
Another point to bear in mind when considering attempts to stoke the 'supply of financial investment' side of the impact investment market, was the inability to effectively address the "conservative and unimaginative"[xxxvii] approach of charity trusts in the UK. In contrast to the US, where charitable foundations were required to invest a percentage of their assets into 'mission-related investments', there was no such directive in the UK to prevent its SRI community (worth an estimated £65bn in 2000)[xxxviii] from continuing to "opt for investment in large listed companies over newer social businesses".[xxxix] This failure persisted despite numerous efforts to address it.

Despite the UK's position as "the undeniable leader" of the impact movement on the continent,[xl] providing its domestic market with an innovative regulatory model, government-led initiatives and substantial financial support, the same could not be said for the state of the UK private sector's wider engagement with impact, especially when compared to the likes of the Dutch and the Nordic states. In fact, UK financial institutions appear to be well behind with regards to assets managed in, or resources allocated to impact investing. As alluded to above, ClearlySo believes that this curious dichotomy may be partly (and ironically) due to the substantial extent of the UK government's intervention to encourage the impact investment sector; the unintended consequences of which may have led private and mainstream financial institutions to erroneously believe that their role in developing the sector was superfluous to the public sector's financial resources and expertise.

As a consequence of this dynamic, there ultimately remained an impasse in the markets between the quality of impact enterprises on offer and the "well-structured investments"[xli] capable of attracting the private and institutional capital critical to establishing a sustainable and effective impact investment sector in the UK. By the end of the SITF's initial mandate in 2010, the impact investment sector remained well and truly self-contained. Whether it succeeded in its vision of "unleashing new sources of capital"[xlii] is highly contestable, all the more so when one considers that the top ten providers of social finance in 2010 – nearly all of which

were pre-existing players[12] – were responsible for 96% of the UK's impact investment by the end of the decade.[xliii] In ClearlySo's opinion, this represented a categorical failure to draw in the "significant private investment" necessary to progress the sector away from a "culture of philanthropy, paternalism and dependence towards one of empowerment, entrepreneurship and initiative"[xliv] – one of the key objectives of the SITF recommendations of October 2000. The chart below, sourced from the Young Foundation's '*Social Venture Intermediary Survey*', demonstrates the extent of this funding concentration.

In 2010, the Top 10 Impact Investors Accounted for 96% of Social Finance Provision[xlv]



12 The market was dominated by four social banks (Charity Bank, Triodos, Unity Trust Bank and Ecology Building Society) which together accounted for c.70% of the impact investments made in 2010 (Young Foundation)

Reasons for the sector's recent growth

The more recent growth of impact investment has been accelerated by the emergence of mainstream pioneers drawn to the prospects of outsized market growth, driven by the demand of an increasingly values-aligned millennial generation,[13] and supported by a tighter regulatory environment as political bodies increasingly converge on effective impact-related policy. Fittingly, this positive momentum has followed the government's diminishing involvement within the impact investment sector, as the public sector's focus and funds have largely been re-directed elsewhere.

Entry of mainstream pioneers

We believe that the growing legitimacy and widespread adoption of impact investing can be attributed to three categories of pioneers that triggered the domino effect across all constituents of the mainstream capital markets:

The first category of pioneers consists of the *private equity heavyweights* that first sought to prove, under the scrutiny of the wider financial markets, that investing with a social purpose could in fact add "value and diversification"[xlvi] that mainstream funds were unable to achieve. Bain Capital, TPG and Partners Group essentially provided a basis for the all-important proof of concept.

In July 2017, Bain Capital announced the launch of its Double Impact Fund and, in doing so, delivered the real "tipoff"[xlvii] that impact investing had reached a new stage in the capital markets. Despite the well-known challenges for first-time fund managers, the Double Impact Fund successfully raised 56% more than its initial target by securing commitments of $390m. Convinced that the fund could achieve private equity-style returns while still being "very impactful",[xlviii] Deval Patrick, Head of the Double Impact Fund (and former Governor of the US state of Massachusetts), would have been fully aware of the fund's significance for the wider impact sector when he said "we're being closely followed. We owe it to the field to do it well".[xlix]

In October 2017, TPG "set up the world's biggest and most ambitious impact investment fund".[l] Launched in early 2017 with an initial target of $1.5bn, demand would yet again surpass expectations as the TPG Rise Fund

13 Set to inherit an estimated US$40 trillion in the next 40 years (knowledge.insead.edu)

successfully raised $2.0bn.[14] The fund set out to "bring the rigor of financial performance measurement to the assessment of social and environmental impact", with the fund only considering those opportunities that could deliver a minimum 2.5x 'Impact Multiple of Money' for investment. While the Rise Fund is restricted from disclosing its financial returns,[15] one only needs to consider the recent news that TPG will be returning to the market for a second larger ($3.5bn) impact fund in early 2019 to speculate about its popularity with investors.

Lastly, Partners Group, the highly-regarded Swiss alternative asset manager, announced in March 2018 the launch of a $1.0bn impact fund dedicated to investing exclusively in line with the United Nations Sustainable Development Goals. According to the Financial Times, the PG Life fund will target 8% to 12% net returns and will hold a 75% equity allocation.[li]

BainCapital Double Impact	The Rise Fund	PG Impact Investments
Date of raise: July 2017	**Date of raise**: October 2017	**Date of raise**: March 2018
Size: $390m	**Size**: $2bn	**Size**: $1bn
Focus: Sustainability, health and wellness, community building	**Focus**: Agriculture, education, energy, financial services, healthcare, infrastructure	**Focus**: Exclusively the UN Sustainable Development Goals

In ClearlySo's opinion, the importance of these first-mover, *heavyweight* private equity firms can hardly be underestimated. While they certainly helped to elevate the sector's profile within more reticent institutional circles (note the launch of the Impact Capital Managers network in April 2018),[16] it could be argued that their most material contribution would be to unlock the liquidity that would be transformative to the functionality of the impact sector as a whole going forward. As reported by ImpactAlpha:[lii]

> *"The arrival to impact investing of private equity players like Bain and TPG means not only larger raises from investors (making possible big institutional checks) and bigger investments in companies (providing middle-market growth capital to scale up revenue-generating enterprises). It also broadens the range of possible exits for early-stage investors" and "creates at least a promise of liquidity that could help pull in early-stage impact investors as well"*

This quote also seems to ring true for the second category of pioneers, the well-respected *niche mid-market players*. Indeed, the launch of Palatine Private Equity's £100m Impact Fund[17] in September 2017 could be

14 The $2.0bn was the maximum allowed under the capped terms of the fund (Bloomberg)
15 Note that TPG Growth has generally hit mid-20% IRR in recent years (Barrons)
16 Distinguished group of 25 leading impact investors with over $5bn of assets (Renewal Funds)
17 Note: ClearlySo provided advisory services to Palatine prior to the launch of this fund and ClearlySo's CEO serves on its Advisory Board

heralded as "one of the most important events in the UK and European impact investment industry".[liii] As touched upon at the outset of this paper, the UK impact industry had previously been dominated by subsidised funds, making Palatine the "first mainstream PE House in the UK"[liv] to raise a dedicated impact fund. This development was subsequently followed by the announcement of M&G's £45m Impact Financing Fund in April 2018, deemed to be the first multi-sector impact fund dedicated to private and illiquid debt investments.[lv] Together, alongside Cheyne Capital's £240m Social Property Impact Fund established in November 2014 to tackle the chronic shortage of housing solutions for disadvantaged groups in the UK, there was soon an emergence of diverse,[lvi] innovative and specialist products available to a sector that had previously been "woefully"[lvii] underrepresented by financial institutions. It could be said that it was the *niche mid-market players* that had essentially provided the much-needed flexibility and sophistication to revolutionise the breadth of financial solutions on offer to impactful enterprises and, in doing so, had further bridged the gap between the sector's inefficient and malfunctioning supply and demand dynamics.

Palatine impact	M&G Investments	Cheyne Capital
Date of raise: September 2017	**Date of raise**: April 2018	**Date of raise**: November 2014
Size: £100m	**Size**: £45m	**Size**: £240m
Focus: Multi-sector UK mid-market private equity investments	**Focus**: Multi-sector and predominantly private and illiquid debt investments	**Focus**: Social property – housing solutions for the disadvantaged in the UK

The third category of pioneers that we believe to be responsible for the rapid adoption of impact investing among mainstream financial circles, consists of the *fund of funds*. French insurer and investment manager AXA Investment Managers ("AXA") launched its first social impact fund in April 2014 with €150m of its own internal capital to invest in a "combination of private equity and microfinance funds, aiming to improve access to financial services, healthcare and education".[lviii] AXA subsequently launched a second €200m impact fund in 2016, raised from external sources of capital this time, and is rumoured to be considering the launch of further funds later this year.

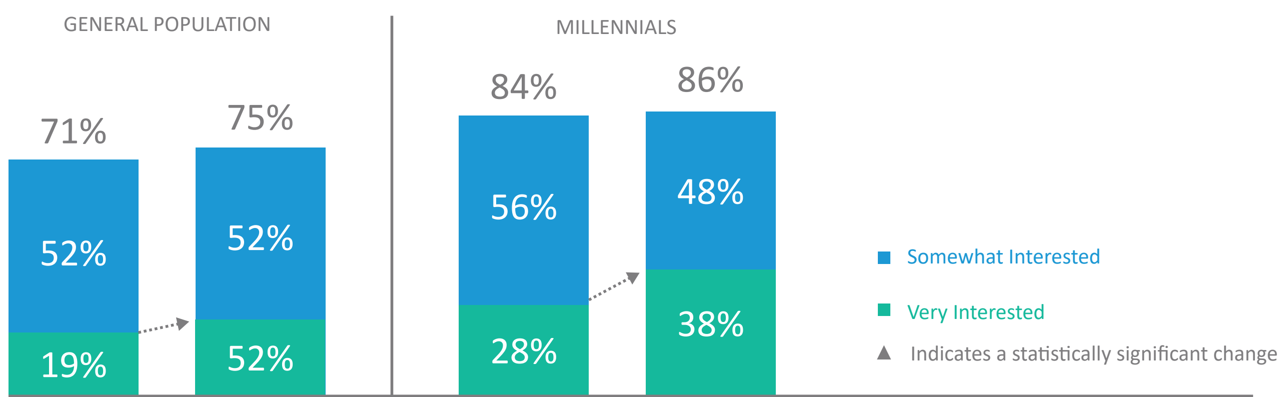
AXA Investment Managers	Lombard Odier – Lombard Odier Darier Hentsch	Kempen
Date of raise: April 2014	**Date of raise**: April 2017	**Date of raise**: February 2018
Size: €150m	**Size**: Undisclosed	**Size**: Undisclosed
Focus: Financial access, financial services, healthcare, education	**Focus**: Financial inclusion, financial services, and fair trade in the emerging markets	**Focus**: Health and wellbeing, clean water / sanitation, energy, responsible consumption

Other prestigious names followed AXA's lead, with the likes of Lombard Odier launching its Global Responsible Equity Fund in April 2017 and Dutch asset manager Kempen Capital Management establishing its Global Impact Pool in February 2018. The quality and reputation of these *fund of funds* provided yet further legitimacy to the impact sector, additional sources of capital for impactful enterprises and, potentially most significantly of all, a route to market for a substantial number of more risk averse investors looking to gain some initial exposure to the sector through indirect investments.

Generational shift in client demand

This, rather fittingly, brings us to the second element driving the impact investment industry's recent growth – the surge in client funds flow into sustainable investment strategies, which Ernst & Young ("EY") estimates to have grown by 107.4% annually since 2012,[lix] and without which the mainstream pioneers may have struggled to launch their ground-breaking and sector defining initiatives. The demand for impactful investments has been driven, in part, "by millennials who prefer to invest in alignment with personal values".[lx] As illustrated below, Morgan Stanley's 2017 'Institute for Sustainable Investing' found that 86%[18] of millennials are interested in "investing in companies or funds that aim to generate market-rate financial returns, while pursuing positive and/or environmental impact".[lxi]

Interest in Impact Investing is Growing, Especially Among Millennials[lxii]

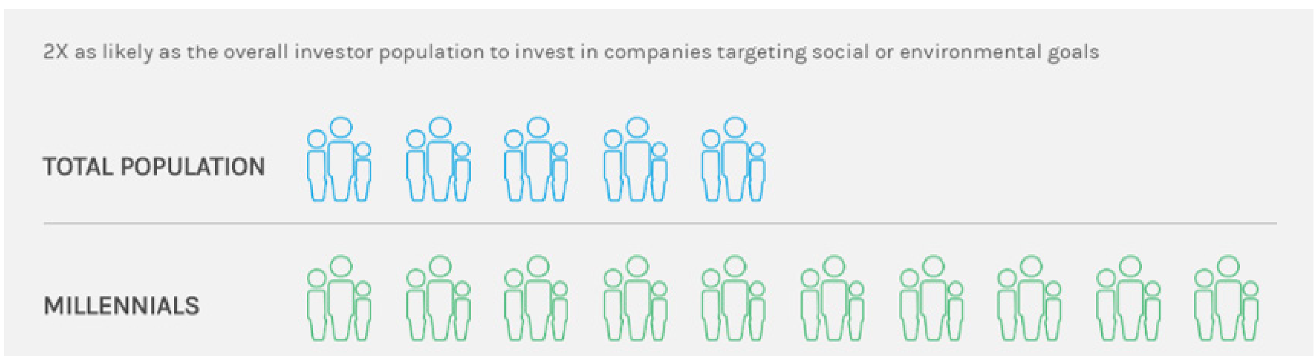


While these statistics alone are effective in demonstrating the extent of the shift in investor mindsets towards impact investing, they are all the more profound when considered alongside the ongoing and corresponding shift in global financial and non-financial assets. According to Accenture, $30 trillion of intergenerational wealth is expected to be passed on to millennials in North America alone over the next 30 to 40 years.[lxiii] Given that millennials are "twice as likely"[lxiv] as the overall population to invest in impactful enterprises (see the following illustration), the impact investment arena could be set for a period of sustained growth. To quote the Stanford Social Innovation Review, "the wealth transfer to millennials has the potential to direct

18 38% of which categorised themselves as being 'very interested' in the sector, representing a 36% increase from the last Morgan Stanley survey in 2015

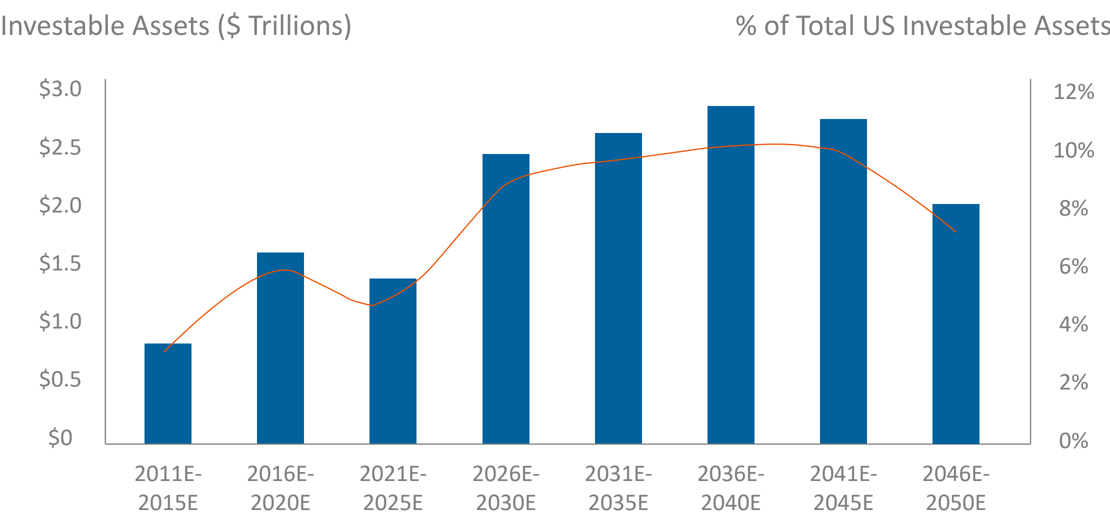
billions of dollars towards social and environmental good and cement this important practice as a mainstream investment strategy".[lxv]

Millennial Investors are Making More Impact Investing Decisions[lxvi]



Whether millennials are prone to an enhanced sense of social consciousness, or whether it is in fact their widely-recognised need for instant gratification that has driven this widespread demand for impactful products, they certainly seem to be playing a pivotal role in ensuring that mainstream institutions (namely family offices and private wealth managers) react to this shifting investor mindset and thus proactively adopt impactful strategies within their advisory services. In truth, the growing financial influence of pro-impact millennials, let alone the up and coming Generation Z,[19] will leave mainstream institutions with little option but to adapt their traditional ways. According to EY, when capital passes from one generation to the next, financial institutions "typically lose 70% to 80%" of those assets,[lxvii] creating an opportunity for values-based investment options to play an important role in both retaining and growing client networks – a significant incentive for financial institutions to continue developing impact investment products. See the Accenture graph below which illustrates the forecast transfer of investable assets in the US alone through to 2050.

US Investable Assets Transferred by Year[lxviii]



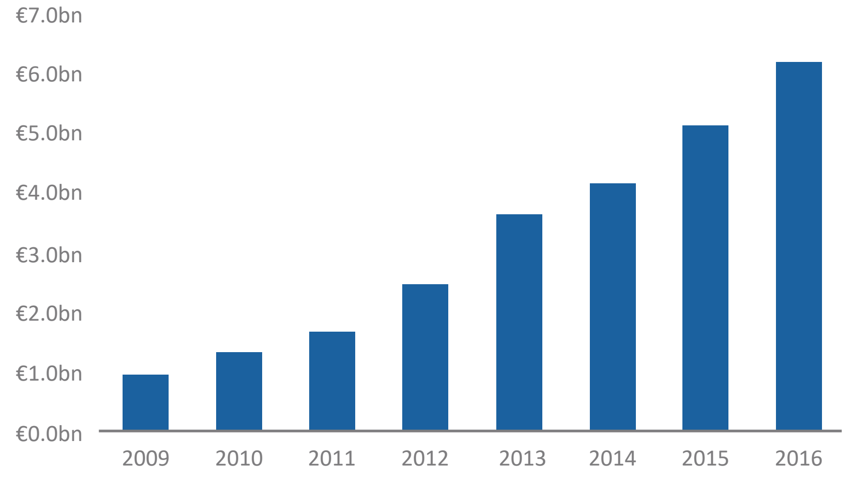
19 Cone Communications found that 94% of Generation Z believe that companies should help to address social and environmental issues, compared to 87% of millennials (Morgan Stanley, 'How Younger Investors Could Reshape the World', January 2018)

While this fundamental sociological change in investor mindsets is positive for impact investing, it is important to note that there are also structural levers that can be pulled, or even developed, in order to improve wider 'retail' participation in impact investing – a development that Triodos labelled as being "vital to the long-term success of the market".[lxix]

The Solidarity Investment Fund model in France ('*les Fonds Solidaires*') is an example of one such highly successful mechanism. Originally launched in February 2001, and made compulsory in 2008, French legislation requires companies with more than 50 employees to offer their staff the option to invest in socially responsible '90/10' employee savings schemes, which are specifically designed to allocate up to 10% of their capital in non-listed "eligible social enterprises".[lxx] The remaining 90% is then invested in listed companies following SRI principles or other mainstream assets.[lxxi] The '90/10' funds have been an overwhelming success in France and a relatively effortless mechanism through which to "mobilise private capital from non-qualified investors"[lxxii] into impactful SMEs.

Totalling approximately €200m of savings in 2002,[lxxiii] Solidarity Investment Funds accounted for €1bn in 2009, before growing to €6.2bn by the end of 2016,[lxxiv] and were reported to have reached €8.6bn by December 2017.[lxxv] This rapid growth is largely testament to their growing popularity amongst employees,[20] which has in turn succeeded in 'democratising' social impact investing in France. The Finansol-sourced graph below illustrates the rapid growth of assets under management within these funds. The impact reports published by the Solidarity Investment Funds outline the quantifiable and measurable benefit of the portion dedicated to 'eligible social enterprises', while the conventional structure of the fund's remaining 90% balance helps to target almost the "same financial performance, liquidity and risk"[lxxvi] as a mainstream fund. In fact, it has even been suggested that Solidarity Investment Funds "offered greater stability and resilience of returns" during periods of financial crisis.[lxxvii]

The Rapid Growth of Assets Under Management in Solidarity Investment Funds (€)[lxxviii]



20 Note: Social Investment Fund deposits are reported to have multiplied by 5.5x between 2011 and 2018 (Finansol)

This is a view that resonates across impact investments more generally, for they seem to have low rates of correlation with mainstream assets – suggesting that they may be useful from a portfolio diversification perspective. Analysis performed by the SITF in 2014, indicated that investors with "an 8-12% impact investment allocation… may see improved diversification and a slightly better expected financial return".[lxxix] This could enhance the appeal of impact investments amongst those investors who believe that turbulent and volatile markets will be a feature over the next few years. The same report commented that "the combination of improved portfolio risk-adjusted returns, while achieving significant societal impact, could become a powerful driver of asset allocation decisions over time".[lxxx]

To a certain extent, the recent surge in investor demand for impact investments may have seen it reach sufficient scale for its ongoing growth to be relatively self-fulfilling. In other words, the more demand that accumulates for impactful investment solutions, the more mature the impact investing market is set to become, with investments that more closely mirror mainstream investment opportunities. This has been, and will continue to be, critical to resolving one of the impact investment sector's "chief barriers" to advancement – its "paucity of robust research on financial performance".[lxxxi] Sector specific research and financial reporting will continue to evolve as financial institutions compete to demonstrate both the extent of their industry knowledge and successful track record of impact investing.

According to the Wharton School Social Impact Initiative, additional research in the field is essential to "providing both GPs and LPs with the data needed to understand the landscape and to potentially unlock additional capital in support of scalable impact".[lxxxii] This is certainly true of more recent studies within the sector that have sought to analyse the financial performance of impact funds. ClearlySo believes that reports such as '*Introducing the Impact Investing Benchmark*', compiled by Cambridge Associates and GIIN in June 2015, have played a pivotal role in dispelling the incongruous perception among mainstream investors "that impact investing necessitates a concessionary return".[lxxxiii] By demonstrating, for example, that private impact investment funds launched between 1998 and 2004, in aggregate, "outperformed funds in a comparative universe of conventional PI funds",[lxxxiv] these studies may have helped to foster the continued growth of the sector by encouraging additional inflows of investor capital potentially drawn by the knowledge and understanding that "the strict dichotomy of strong returns versus strong impact may be unfounded".[lxxxv]

In the opinion of ClearlySo, these reports may not have fully taken into account the differing composition of the impact funds analysed as compared with market averages. Furthermore, the definition of what constitutes an impact fund was far less clear in the 1990s and is still highly subjective. In essence, we believe that it is premature to make bold and categoric assertions regarding the performance of impact funds as compared with the mainstream – it is simply too early in their lifecycle for any comparison to be truly representative. Nevertheless, based on our experience with impact funds and direct investments, it would appear that any concession is minimal, and that impact investments may have a lower rate of default than similar mainstream assets – the risk-adjusted return may also be similar to mainstream investments.

Corporate success stories capturing public attention

The evolving legitimacy of impact investing amongst mainstream financial institutions, as well as its growing demand amongst capital owners, could also be attributed to the emergence of impactful enterprise success stories that have increasingly caught the public eye. These help to support the notion that social impact and financial success may be positively correlated.

The Body Shop, the UK's first natural beauty company, launched in Brighton in 1976 "as an ethical alternative to the traditional approach to cosmetics",[lxxxvi] with a range of 25 products to be sold in reusable containers with handwritten labels.[lxxxvii] Within six months, the owners opened their second shop with a £4,000 loan from a family friend after their request for funding had been turned down by a number of high-street banks.[lxxxviii] The popular uptake for the company's ethically sourced products saw The Body Shop float on the London Stock Exchange in 1984 at an £8m valuation, which rapidly rose to £300m. The business generated £419m of revenues in 2005,[lxxxix] and accounted for 2,085 branches in 54 countries across the globe by early 2006.[xc] In March 2006, cosmetics giant L'Oréal acquired The Body Shop at an enterprise value of £703m,[xci] citing the company's "distinct culture and values" as a complimentary driver to the French cosmetic giant's future growth.[xcii] More recently, The Body Shop was purchased by Brazilian cosmetics maker Natura Cosméticos for an enterprise value of €1bn.[xciii]

Founded in 1988 with an investment of just £2,000, Abel & Cole would prove to be the pioneer of the delivery box service industry, bringing "the best of the organic world from farmers, makers and bakers to homes up and down the country".[xciv] Within less than two decades, the business would grow from a South London door-to-door potato sales company into a multi-million pound business worth close to £40m, following a partial exit to Phoenix Equity Partners in 2007.

Launched in 1991, the organic chocolatier Green & Blacks has become one of the best-known confectionery brands in the UK. The company's commitment to ethically sourced cocoa saw it widely recognised as one of the leading figures within the impact sector, winning the Worldaware Business Award as well the Fairtrade mark for its Maya Gold chocolate bar in 1994.[xcv] Between 2002 and 2005, Green & Blacks' revenues increased from £5m to £29m,[xcvi] resulting in a 5.1% market share of the UK large-block chocolate market.[xcvii] This remarkable +544% sales growth over just four years led to Cadbury Schweppes acquiring the

company in 2005 at an estimated £20m valuation.[xcviii]

JustGiving, the online charitable donations platform, was launched in 2001 with the belief that its social impact would only be maximised were the founders able to establish a well-run and commercial enterprise.[21] JustGiving succeeded in doing just that and has grown into "the world's leading online charitable fundraising business"[xcix] despite a mere £5m to £6m of angel investment. In October 2017, the company was acquired by US software firm Blackbaud Inc. for an aggregate purchase price of £95m,[c] the equivalent to a c.19-20x exit multiple. Note that since inception, the firm has helped to raise more than $6bn for the charitable sector and other good causes via its website, thereby delivering enormous impact.

TOMS®, the shoe company famous for its canvas *alpargatas*, was founded by Blake Mycoskie in 2006 to help impoverished children in Argentina. Mycoskie funded the company's early growth with approximately $300k of seed capital raised through the sale of another of his business ventures.[ci] The popularity behind TOMS® has largely been driven by its One for One™ business model, which ensures that the company matches "every pair of shoes purchased with a pair of new shoes given to a child in need".[cii] Since its initial launch, TOMS® has donated over 60 million pairs of shoes to deprived communities worldwide. The company also expanded into eyewear in 2011, through which it has now helped over 400,000 people to have their sight restored.[ciii] In August 2014, Bain Capital beat off a number of private equity competitors to the acquisition of a 50% stake in TOMS®, in a deal that valued a company "synonymous with social responsibility and corporate impact"[civ] at an estimated $625m.

In 2007, former England squash player John Treharne founded The Gym Group. The company provides low-cost "health and fitness facilities in purpose-built gyms which are open 24 hours a day and mainly located in underserved areas".[cv] Bridges Ventures was the key seed stage investor. In 2017, just a decade after the company's launch, The Gym Group reported £91.4m of revenue, opened its 100th club, and recorded its highest ever membership base with 26.7m gym visits that same year.[cvi] After securing further investment from Phoenix Equity Partners in June

21 Note: JustGiving and its co-founders have been past clients of ClearlySo

2013, The Gym Group eventually floated on the London Stock Exchange in November 2015 at a £250m valuation.[cvii]

The relatively recent success of Bulb, the renewable energy provider incorporated in 2014, reinforces the argument that "impact investments have the potential to generate substantial impact and sensational financial returns".[cviii] In June 2017, Bulb raised a successful Series A[22] round of £5.7m of angel and institutional capital at a reported post-money valuation of £60m.[cix] A little over a year later, the company raised a further £60m from leading technology investors DST Global and Magnetar at an estimated post-money valuation of £411m.[cx] Noting that Deliveroo's valuation was £508m at the same stage of the company's evolution,[23] Beauhurst recently suggested that "Bulb could be on course for a $1bn+ valuation within the next two years, perhaps even less"[cxi] should it manage to maintain this exceptional rate of growth.

Pressure from influential groups

As alluded to earlier in the report, ClearlySo believes that one of the critical components to the sector's recent evolution as a mainstream investment theme has been the increasingly effective role played by political and regulatory bodies in the delivery of constructive impact-related initiatives. These frameworks, policies, and reports could be considered instrumental in supporting the sector's underlying supply and demand dynamics, both of which are critical to impact investing's long-term sustainable growth.

In 2006, the United Nations launched the UN Principles for Responsible Investment ("UN PRI"). Developed by impact conscious investors for the benefit of the wider market, these six investment principles were aimed at "encouraging the incorporation of ESG matters into investment practice".[cxii] Despite an increase in the number of UN PRI signatories from 100 members at the time of its launch to over 1,965 by September 2018,[cxiii] including major institutional investors such as ABN AMRO, Hermes and Janus Henderson,[cxiv] the original framework may not have been a resounding success in resolving the industry's lack of "a universal standard of measuring positive impact".[cxv] Consequently, in 2018 the UN PRI set out to take a firmer stance against companies failing to adhere to its guidelines, threatening to "delist signatories whose progress in implementing the Principles is not sufficient to meet a basic criteria of being a signatory,[24] as defined by the UN PRI".[cxvi] In fact, it was

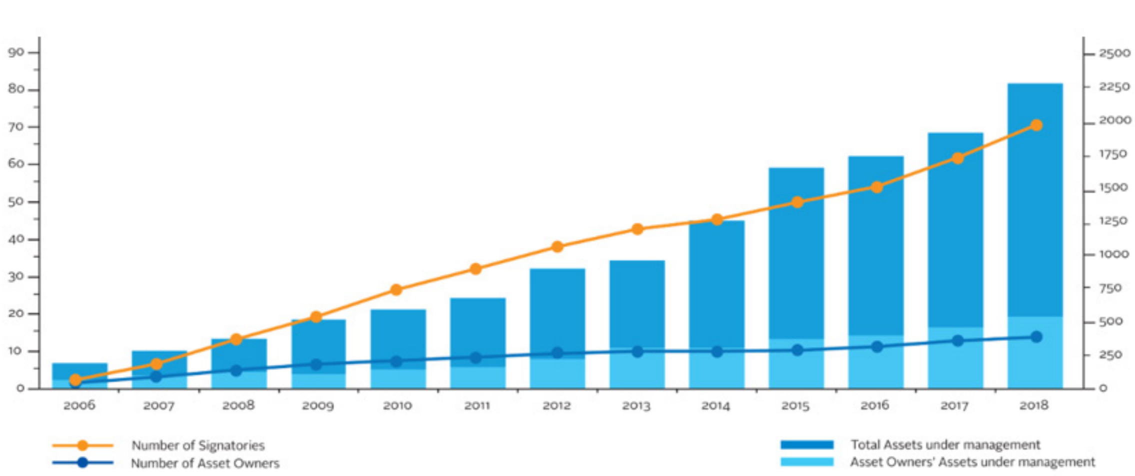
22 Note: ClearlySo was the Appointed Advisor to Bulb for the June 2017 Series A capital raise

23 Deliveroo reportedly in preliminary discussions for a next round of fundraising at a valuation of £2.3bn - £3.1bn in Nov-18

24 The 'minimum requirements' to be satisfied before 2020: (i) investment policy that covers the firm's responsible investment approach, covering >50% of AUM; (ii) internal / external staff responsible for implementing RI policy; (iii) senior-level commitment and accountability mechanisms for RI implementation

reported that the UN PRI had placed 185 of its 1,965 signatories on a watchlist as a result of "failing to live up to their promised ESG attributes".[cxvii] The recent initiatives to increase accountability within the sector appear to be a clear move to ensure that firms are genuinely implementing the UN PRI principles, rather than just relying on them for marketing purposes, and should hopefully be a positive development for the industry's increasing adoption and legitimacy amongst investors. The UN PRI graph below shows the growth in both the number of signatories and assets under management between 2006 and 2018.

The Growth in UN PRI Signatories and Assets Under Management[cxviii]



In September 2015, all 183 Member States of the United Nations[25] unanimously adopted the 2030 Agenda for Sustainable Development as "a blueprint to achieve a better and more sustainable future for all".[cxix] To achieve this ambitious goal, which will require an estimated $5 to $7 trillion of investment over the next 12 to 15 years,[cxx] the United Nations compiled 17 Sustainable Development Goals ("SDGs") as a "rallying theme for asset managers, corporates and other institutions"[cxxi] to ensure that capital is allocated as efficiently as possible towards positive impact investments.[cxxii]

It is possible that the adoption of the SDGs has benefited the wider impact sector on two fronts. Firstly, the historic summit may have served as a global and high-profile reminder that increased collaboration between the public sector, private sector and individual investors will be fundamental to unlocking the vast amount of capital needed to achieve the 2030 Agenda. Secondly, and perhaps more importantly, the SDGs now offer asset managers a globally recognised framework through which to identify, and to a certain extent measure, impact investment opportunities.

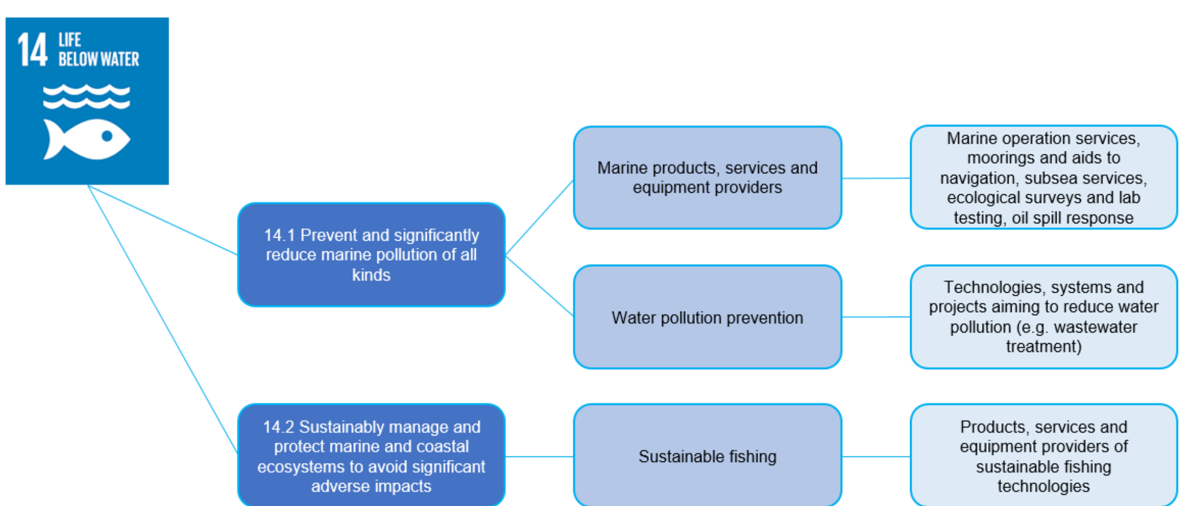
This is likely to be a key development for the widespread adoption of impact investing. As indicated in the Advisory Group's report '*Growing a Culture of Social Impact Investing in the UK*', confusion over what "social impact investing means" has been a significant barrier to adoption of impact investing for both private and institutional investors to date.[cxxiii] The SDGs, therefore, offer a degree of transparency and a common

25 As an active contributor to sector specific research, including its August 2018 report designed to offer best practice on what constitutes as impact investment, the UN has played a key role in improving "the clarity and scalability of the impact investing industry", enhancing investors' knowledge of the space and, in doing so, their propensity to commit to impact investing

understanding to the previously supposedly opaque world of impact investing.

As suggested by BNP Paribas, major institutional investors – most notably the Dutch pension funds APG and PPGM[26] – can now rely on the SDGs in order to define "a comprehensive decision tree to find sustainable development investments, i.e. investments that meet the financial risk and return requirements and support positive social and/or environmental impact through their products and services".[cxxiv] The BNP Paribas sourced image below offers an example of such an investment framework. Likewise, the launch of the Danish SDG Investment Fund in June 2018, a "public-private partnership"[cxxv] backed by the Danish state and six leading pension funds,[27] demonstrates that this framework could help to unlock substantial capital flow, as companies and investors both benefit from a mutual platform through which to communicate and analyse the alignment of environmental and social objectives within an enterprise's corporate strategy.[28]

Illustrative APG & PPGM Investment Framework Based on the Sustainable Development Goals[cxxvi]



Another potentially key development for the sector's long-term growth prospects, has been the increased governmental action in both the UK and Europe in 2018 in an attempt to establish an improved and recognised framework with which to facilitate impact investment on a wider scale.

The UK government recently sought to bring much-needed clarification to pension funds' attitude and approach towards impact investment. In its 2017 report '*Pension Funds and Social Investment*', the Law Commission concluded that the barriers preventing pension funds from choosing to make impact investments were largely "structural and behavioural rather than legal or regulatory",[cxxvii] as a number of defined contribution pension schemes in the UK had been seemingly deterred from making impact investments by "a perceived conflict with their fiduciary duty to maximise returns"[cxxviii] and a lack of understanding as to whether they were permitted to do so. Consequently, the government pledged in June 2018 to update investment regulations to

26 Total reported assets of €600bn

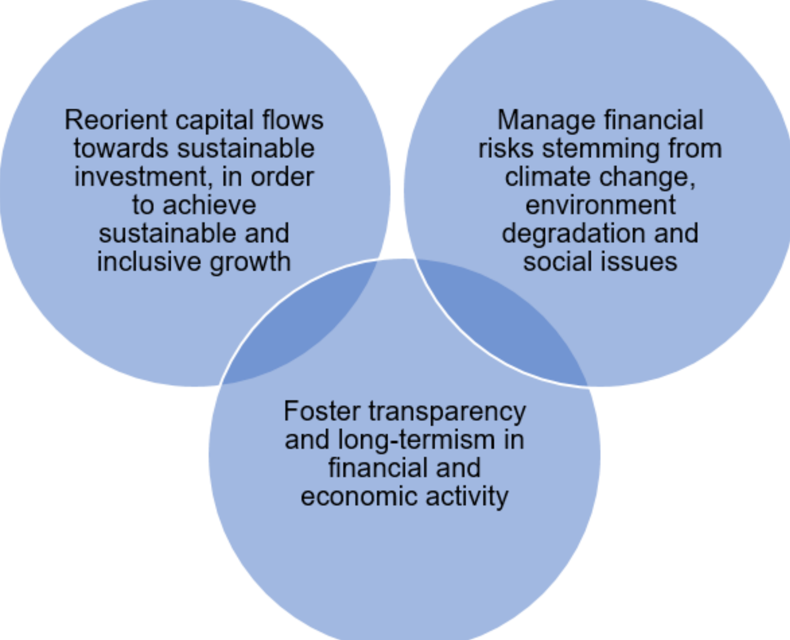
27 The current capital commitment to the Danish SDG Investment Fund is DKK 4.1bn. The pension funds (PKA, PensionDanmark, PFA, ATP JØP/DIP and PenSam) contributing DKK 2.4bn, the IFU and State DK 1.7bn and a private investor DK 80m

28 The GIIN 2018 Annual Impact Investor Survey revealed that more than half of impact investors surveyed reported tracking some or all of their impact performance against the SDGs

help grow "the positive impact of pensions in the UK".[cxxix]

The new rules will not only require trustees to set out how they take into account social, environmental and ethical factors when selecting, retaining and realising investments from October 2019 onwards, but will also require defined contribution schemes to publish an additional statement declaring how investment policies (including key ethical, social and environmental considerations) have been implemented by the relevant scheme on an annual basis from October 2020. With more than £1.5tn of assets currently invested by occupational pension schemes across the country,[cxxx] the impact of this regulatory update could have the potential to be truly significant for the UK's impact investment sector – especially as pension funds continue to grow as more millennials qualify for workplace pensions,[29] making it all the more imperative that pension schemes react to their increasingly impact-oriented investment demands.

European Commission – Action Plan for Financing Sustainable Growth: 3 Main Objectives[cxxxi]



In March 2018, the European Commission adopted its Action Plan for Financing Sustainable Growth (see the chart above),[30] which consists of an ambitious set of initiatives including "proposals for a taxonomy on climate change, environmentally and socially sustainable activities; standards and labels for sustainable financial products; support for sustainable infrastructure; mainstreaming ESG factors into market research and credit ratings; exploring how corporate governance can better enable sustainable finance; enhanced oversight of sustainability by the European Supervisory Authorities" and many more.[cxxxii] The European Commission's Action Plan[31] will likely act as an influential roadmap helping to steer additional public and private capital towards impactful investments, whilst also ensuring that the process of "making sustainable

29 According to government sources 77% of eligible 22 to 29-year olds working in the private sector are currently enrolled in a workplace pension

30 Full report available here: [EC Action Plan for Financing Sustainable Growth (2018)](#)

31 To be implemented by the EC's Technical Expert Group ("TEG"), comprising of 35 members from civil society, academia, business and finance, 10 PRI signatories and 2 members of the SSE Initiative

finance the norm across the EU"[cxxxiii] can be closely and effectively monitored against a pre-determined set of objectives. This initiative has obvious advantages to the impact investment sector across Europe but, should its implementation be deemed a success, it could subsequently evolve into a transformational "blueprint for future discussions in international fora to promote a renewed approach to managing the financial system more sustainably" across the globe.[cxxxiv]

Conclusion

The theme of impact investment does seem to be gaining important momentum. Whether or not the sector has in fact hit "a fork in the road",[cxxxv] as alluded to by Amit Bouri[32] at the opening of the GIIN Forum in Paris in October 2018, there certainly appears to have been a seismic shift in the market's underlying dynamics over the past 18 months. At ClearlySo, we believe that it is this development – namely the marked increase in private sector activity within impact investment – that has the potential to transform 15 years of hype into real prospects for near-term and unprecedented sector growth. The entry of the private sector, led by the financial expertise of institutional pioneers, driven by the demand of an increasingly influential generation of investors, and supported by a growing and widely acknowledged regulatory framework, has in our opinion positioned impact investment at the heart of the mainstream. While impact investment is still some way off Bouri's vision, in which it raises the bar for all investments and establishes a new way of doing business,[cxxxvi] we do believe that the sector is now finally equipped with the appropriate foundations with which to take meaningful steps towards achieving its unbridled potential.

"I think that if you'd said to people 10 years ago that 10 years from now [that] impact investment would be an absolutely recognized term in a mainstream investment industry, I think people [would] have been both surprised and exhilarated by it… Some people might, I think, suggest that there's a certain amount of hype involved, more hype than reality, more hype than money moved… but that's often the case in the early stages of a big movement" [cxxxvii]

- Nick O'Donohoe, CEO of CDC Group and ex-CEO of Big Society Capital (November 2017)

32 CEO of the Global Impact Investing Network

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