Impact Investing Defined

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What exactly is impact investing? Heretofore, it has been a bit of a mash-up and a mystery. Some say it is a strategy largely reserved for the wealthy that strictly funds private equity investments. Some say it is just a new name for socially responsible investing, whereby you can pick up shares in a do-good mutual fund at your corner broker-dealer. Others say it is a mixed bag of both, including public and private equity, as well as debt instruments, domestic and foreign.

The Global Impact Investing Network, the elite New York City-based trade group of impact investors known as The GIIN, has decided to tackle the definition quagmire and not only give us a straight-up explanation, but also core characteristics.

Here's what The GIIN writes:

"Impact investments are investments made into companies, organizations, and funds with the intention to generate social and environmental impact alongside a financial return. Impact investments can be made in both emerging and developed markets and target a range of returns from below market to market rate, depending upon the circumstances.

"The growing impact investment market provides capital to support solutions to the world's most pressing challenges in sectors such as sustainable agriculture, affordable housing, affordable and accessible health care, clean technology and financial services."

I like the all-encompassing aspect of The GIIN's explication. Also worth noting is its further definition, broken into four parts:

1) Intentionality -- The intent of the investor to generate social and/or environmental impact through investments is an essential component of impact investing. These investments are made into enterprises and funds that expand access to critical goods and services and/or generate positive impact through their operations. For example, investors may seek to use investments to increase access to financial services, education, health care, affordable housing or quality employment by underserved populations. Investors may also invest in solutions aimed at mitigating the negative effects of climate change and environmental degradation. Investor activities may be focused in developed or emerging markets, or both.

2) Investment with return expectations -- Impact investments are expected to generate a financial return on capital and, at a minimum, a return of capital. While grants are not themselves impact investments, they can play an important role in enabling impact investing -- for instance, through incubating early-stage business models, providing certain forms of credit enhancement, providing technical assistance or funding needed research and development.

3) Range of return expectations and asset classes -- Impact investments generate returns that range from below market (sometimes called concessionary) to risk-adjusted market rate. Impact investments can be made across asset classes, including but not limited to cash equivalents, fixed income, venture capital and private equity. Impact investors may also earn fees through the provision of catalytic instruments such as guarantees.
Investors’ return expectations and the instrument(s) in which they invest reflect their intent and are typically driven by the economics of the investment.
For instance, some may wish to support higher risk, early-stage social enterprises in challenging markets or invest pursuant to various regulatory mandates, often with concessionary returns; others may choose to finance the expansion of proven business models to reach scale or invest in credit-enhanced transactions, in the expectation of market or near-market-rate returns.

4) Impact measurement -- A hallmark of impact investing is the commitment of the investor to measure and report the social and environmental performance and progress of underlying investments. Impact measurement helps ensure transparency and accountability, and is essential to informing the practice of impact investing and building the field.

To be sure, as The GIIN points out, "Investors’ approaches to impact measurement will vary based on their objectives and capacities, and the choice of what to measure usually reflects investor goals and, consequently, investor intention." Therefore, best practices for impact investing should include:

- Establishing and stating social and environmental objectives to relevant stakeholders.
- Setting performance metrics/targets related to these objectives using standardized metrics wherever possible.
- Monitoring and managing the performance of investees against these targets.
- Reporting on social and environmental performance to relevant stakeholders.