IWRM Action Hub

RESOURCE

When Can Impact Investing Create Real Impact?

|

Author(s)
Brest, Paul Born, Kelly

Description / Abstract

There has been an increasing realization that, along with philanthropy and government aid, private enterprise can contribute to solving social and environmental problems. At the same time, a growing number of investors are expressing a desire to “do good while doing well.” These are impact investors, who seek opportunities for financial investments that produce social or environmental benefits. However, the rapid growth of the field of impact investing has been accompanied by questions about how to assess impact, and concerns about potentially unrealistic expectations of simultaneously achieving social impact and market-rate returns.

This article is addressed to impact investors who wish to know whether their investments will actually contribute to achieving their social or environmental (hereafter, simply “social”) objecives. We introduce three basic parameters of impact: enterprise impact, investment impact, and nonmonetary impact. Enterprise impact is the social value of the goods, services, or other benefits provided by the investee enterprise. Investment impact is a particular investor’s financial contribution to the social value created by an enterprise. Nonmonetary impact reflects the various contributions, besides dollars, that investors, fund managers, and others may make to the enterprise’s social value.

The most novel and intriguing question we consider is whether and when investors can expect both to receive risk-adjusted market-ratereturns on their investments and to have real social impact: that is, can investors both make money and make a difference? That is the claim made by many impact investment funds. One recent study asserts that most of what it estimates to be a $4 billion impact investing market involves investments producing market rate returns.

We posit that a particular investment has impact only if it increases the quantity or quality of the enterprise’s social outcomes beyond what would otherwise have occurred. Under this definition, it is readily apparent that grants or concessionary investments (investments that sacrifice some financial gain to achieve a social benefit) can have impact: By hypothesis, an ordinary market investor, who seeks market-rate returns, would not provide the capital on as favorable terms, if at all.

But if an impact investor is not willing to make a financial sacrifice, what can he contribute that the market wouldn’t do anyway? We believe that in publicly traded large cap markets, the answer is nothing: Even quite large individual investments will not affect the equilibrium

of these essentially perfect markets. The frictions or imperfections inherent in some smaller, private markets, however, may offer the possibility of achieving both market returns and social impact. For example, someone with distinctive knowledge about the risk and potential returns of a particular opportunity may make an investment that others would pass up.

The question of investment impact is of obvious importance to investors who want to make a difference. Although we do not reject the possibility of earning market-rate financial returns while achieving social impact, we are skeptical about how much of the impact investing market actually fits this description.

Publication year
2013

Publisher
Stanford University

Keywords
Social and Environmental Impact Measuring Impact

Thematic Tagging
Gender Private Sector Youth
Language English
View resource

Related IWRM Tools

Tool

Impact Investment Market Maps

D1.05