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Impact Investing: A Primer for Family Offices

A report by the World Economic Forum

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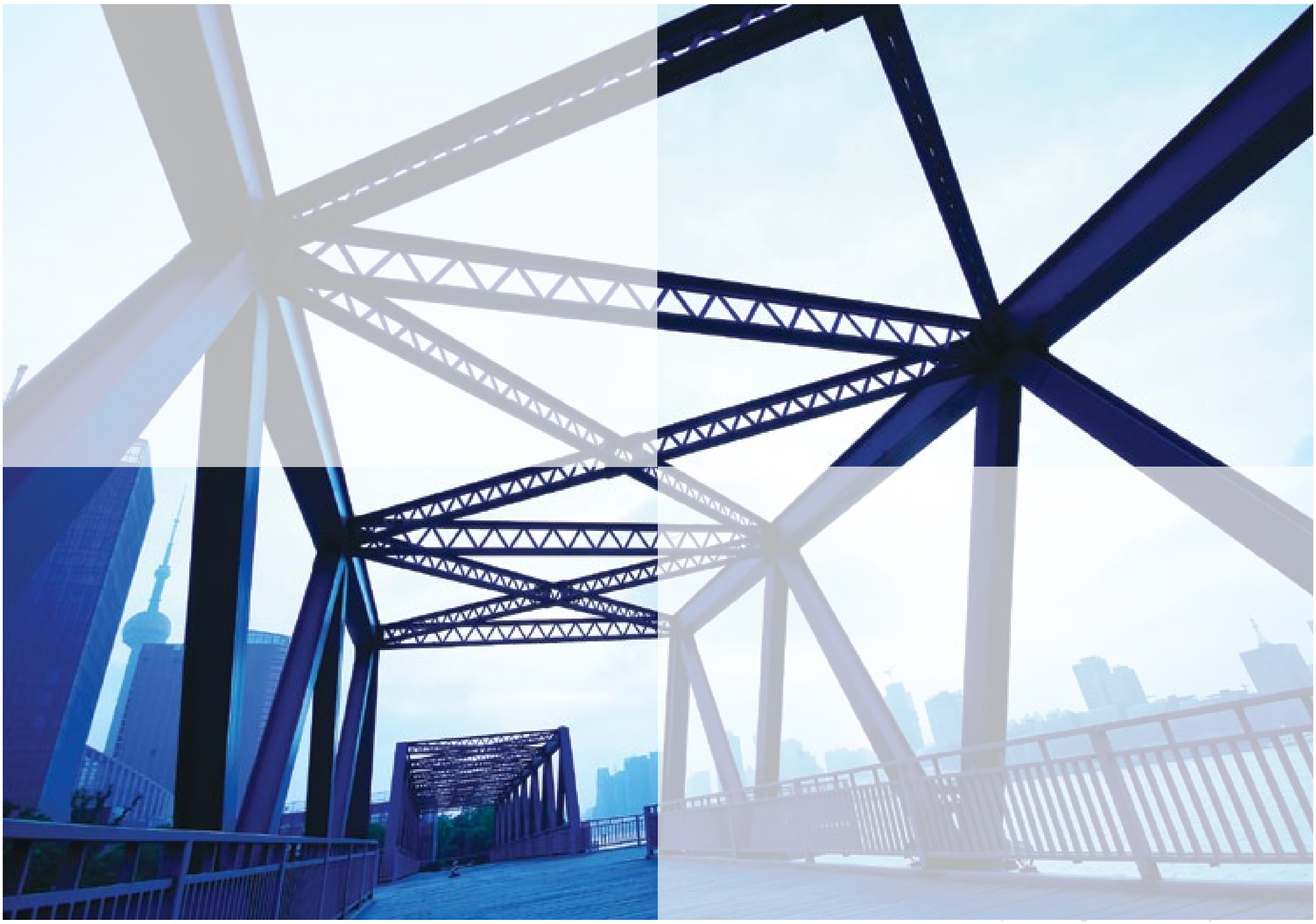

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Impact investing has become a popular topic of discussion, not only with the mainstream media but also with mainstream investors. Yet while impact investing has entered the mainstream mindset, many investors with the enthusiasm and means to engage meaningfully in impact investing lack the informational resources to do so. For most investors today, impact investing still needs to be translated from a compelling concept into a sound strategy. This situation is especially true for family offices.

Family offices can and likely will play a unique and important role in bringing scale to the impact investing sector in the coming years. The reasons for this, further detailed in this publication, include their desire to align family values with investment decisions, the autonomy with which they can make decisions on the deployment of capital and the overall volume of assets under management held by family offices.

Impact Investing – an investment approach intentionally seeking to create both financial returns and positive social impact that is actively measured – has been lauded as an innovative investment strategy with the potential to reconcile key structural shortcomings in traditional financial markets. Moreover, with exogenous trends such as population growth, rising inequality, climate change and resource scarcity gradually affecting investment markets, impact investing offers a progressive approach to mitigating risk. While impact investing continues to gain momentum, the sector remains small in the context of global assets under management and faces systemic challenges, such as lack of standardized metrics for social impact and the long investment horizons often needed to prove the model.

Over the past few years, the World Economic Forum has conducted extensive research on the opportunities and challenges of impact investing – first with an objective assessment of the sector as well as the challenges holding the sector back,[1] second through curating, synthesizing and disseminating the best practices of impact investing practitioners,[2] and third through offering customizable roadmaps with which institutional and private investors can define a competitive strategy for impact investing.[3]

One of the most important insights we have gleaned is that while investors chose to enter the impact investing sector for a variety of reasons, successful impact investors are clear upfront about their intended impact as well as the metrics they will use to measure it. Moreover, as it is an investment strategy and not a rigidly defined asset class, impact investments vary widely not only in their impact profile, but also in how the opportunity is sourced, selected and managed for success. Investors' motivations, operational contexts and goals for impact investing are also highly diverse – there is no model that fits every investor. As such, there is no science to being an impact investor; it is more of an art. With this in mind, the location for this report launch is apt – during Miami Art Basel (and at the World Economic Forum's convening of next generation of wealth holders).

The goal of this report is to help family offices ask the right questions as they contemplate their path into impact investing. It is important to recognize that impact investing may not suit all investors. There will be family offices which conclude impact investing is not appropriate at this stage for them.

While we are passionate about the potential of impact investing, we acknowledge the best future for the sector is where each investor can make informed choices about their own best interest. Each investor and investment institution needs to evaluate if impact investing fits with its needs, interests and unique context.

It is with that in mind that we offer this report as a resource and tool that family offices can use to begin the conversations internally, to craft and design their own engagement strategy on impact investing with family members, advisers and potential investees, as well as to ensure that not only is their wealth growing in value, but also that their wealth can reflect their values.

We look forward to hearing about your interest in impact investing. Please share your experiences and feedback with us at impactinvesting@weforum.org.

Introduction

Impact investing[4] *is an investing approach that intentionally seeks to create both financial return as well as positive social and/or environmental impacts that are actively measured.* In the past year, impact investing has received increased attention within mainstream audiences, including the G8 Social Impact Investing Taskforce, Pope Francis and the World Economic Forum.

Despite the "buzz" surrounding impact investing, with an estimated $50 billion of assets under management,[5] the sector remains a small proportion of the estimated $13.5 trillion of global funds invested in sustainable and responsible strategies and an even smaller percentage of tens of trillions in global assets under management.[6]

While impact investing is becoming a more frequent topic of discussion among global leaders, asset owners and asset managers, few individuals or institutions have the expertise, tools and understanding of how to put it into practice.

For a more in-depth discussion of the impact investing sector and trends, download the World Economic Forum report: From the Margins to the Mainstream – Assessment of the Impact Investment Sector and Opportunities to Engage Mainstream Investors.[7]

Family offices act as responsible stewards of the wealth of high-net-worth and ultra-high-net-worth individuals, their families and their heirs. Yet after wealth is generated by one generation of a family, an estimated 60% lose that wealth by the end of second generation, and a staggering 90% by the end of third.[8] Many multi-generational family offices are now exploring whether impact investing is a way to unite families around values and positive legacies, thereby more closely involving family members in responsible long-term investing.

Impact investing enables families to be explicit about their shared values and to reflect them in their investment and wealth management decisions. In addition, an impact investing strategy aligned with family values can help to engage a younger generation in the leadership and management of a family office.

According to a 2013 *Financial Times* survey, family offices that are already active in impact investing cite intergenerational wealth transfer, contribution to sustainable economy, contribution to community, family values, risk management and succession planning as top motivations for engaging in impact investing. On average, family offices allocated 17% of their assets under management to impact investments with a broad spectrum of exposure from 1% to 100% for some single family offices in the US, UK and Switzerland.[9]

In light of the fact that some family offices are making impact investments, there are still many more on the sidelines. However, many investors and thought leaders believe that family offices are well-positioned and necessary to influence the maturation and success of the impact investing sector for a number of reasons.

First, family offices have greater discretion and independence in investment decisions compared to other asset owners that may be subject to policy regulation (e.g. pension funds, insurance companies) or that have mandated trusts which limit decision-making (e.g. large foundations). This means that family offices can be flexible in their consideration of investments of varied sizes, geographies and asset classes.

Second, family offices are guided not only by financial considerations, but also qualitative factors such as their standing in the community and inter-generational legacy. In many cases, this makes the discussion about investing for multiple bottom lines easier to have with family offices than with other asset owners.

Third, family offices can play a role in ecosystem building by sharing knowledge, serving as role models and even financing organizations dedicated to sector-building. Estimates show that single and multi-family offices represent roughly $1.6 trillion in assets under advisement in North America.[10] In short, family offices can play a catalytic role in the impact investing sector.

While impact investing may not suit all family offices, for those that choose to become involved, there is a shortage of expertise, tools and frameworks to enable engagement. As a result, despite growing interest, many struggle with the initial steps of engagement. One of the main goals of this primer is to help family offices interested in impact investing to begin to understand how they can put it into practice.[11]

The main target audience for this report is single family offices. It offers useful frameworks and insights for multi-family offices, family businesses, family foundations and high-net-worth individuals as well as policy-makers and advisers. The goal of this primer is to help interested family offices ask the right questions and take the first steps as they contemplate their path into impact investing.

Each family office's motivations, operational contexts and goals for impact investing are unique – there is no standard course that fits every family. While this creates a daunting array of potential engagement opportunities, it also allows for a wide variety of opportunities to engage in impact investing. Thus, rather than prescribing a single approach, the primer offers high-level frameworks and disseminates insights that are the result of extensive conversations with family offices, family businesses, family foundations and advisers.

Spotlight: Statistics and trends that may affect family offices' entry into impact investing

Several demographic, business and socio-environmental trends will affect impact investing over the coming decades:

Rising wealth and increased demand from Millennials

- *Increased wealth:* Over the past 30 years, the wealth within the Forbes top 400 has increased from $125 billion $2.29 trillion today.[12] The number of high-net-worth and ultra-high-net-worth individuals has grown; between 2008 and mid-2014 there was a 54% rise in the number of millionaires and more than double increase in the number of billionaires.[13]
- *Among the ultra-high-net-worth individuals, a growing percentage are self-made billionaires:* The composition among the ultra-high-net-worth individuals has shifted from predominantly inherited wealth to self-made billionaires.[14] Of the 29 people listed on the Forbes under-40 billionaires list (which represent roughly $119 billion in net wealth), 13 people (slightly less than half) are self-made billionaires.[15]
- *Wealth transfer from baby boomers to Millennials:* Over the next four decades, it is projected that the Millennial generation will inherit an estimated $41 trillion from the baby boomer generation.[16]
- *When wealth is inherited, the inheritee switches advisers:* It is estimated that 98% of the time when the next generation inherits wealth, he or she switches advisers.[17]
- *Younger wealth holders are more socially and environmentally conscious:* According to the 2014 Deloitte Millennial survey, nearly 30% of Millennials believe the number one priority of business should be to improve society. They believe business can do more to address society's challenges of resource scarcity (56%), climate change (55%) and income inequality (49%).[18] Nearly 40% of GenX/Y millionaires give more than $30,000 annually to charity versus 6% of the baby boomers.[19]

Increasing demand from women

- *Among the ultra-high-net-worth individuals, a growing percentage are women:* Women control almost half of all US estates valued at more than $5 million.[20] Of the $41 trillion in intergenerational wealth transfer over the next four decades, women will inherit 70%.[21] And, 45% of American millionaires are women and by 2030 roughly two-thirds of private wealth in the US will be held by women.[22]
- *Attitude towards investing among women:* Roughly half of affluent women are interested in environmental or socially responsible investments (compared to one-third of men).[23] Social, political or environmental impacts in evaluating investments were considered "somewhat" or "extremely" important by 65% of women, but only 42% of men.[24]
- *Women making more investment decisions*: 75% of female wealth creators say they are the primary decision-makers.[25]
- *Attitude towards investing among female advisers*: Female advisers report to be more interested than their male counterparts in using sustainable investing funds by a margin of 59% to 34%.[26]
- *When wealth is inherited, the inheritee switches advisers*: When a spouse inherits wealth, 55% of the time he or she switches advisers.[27] Another study shows that 70% of women fire their financial adviser within one year of being widowed.[28]

The growth in impact investing opportunities

- *Climate change makes environment a business imperative:* UNESCO estimates that by 2030 the world will need 30% more water, 40% more energy and 50% more food.[29] The cost of climate change-related impacts on the environment, health and food security could exceed $4 trillion by 2030. Climate change policy could contribute up to 10% to overall portfolio risk.[30]
- *Rise of LOHAS consumers around the world represents growth sector for investment:* Consumers want products reflecting their values and positively influence society. The LOHAS (Lifestyles of Health and Sustainability) market, roughly $300 billion in size, has grown over 10% annually since the early 2000s.[31]
- *Government policies creating incentive and opportunities for impact investing:* As governments design and implement policies and programmes to incentivize capital to flow into socially and environmentally impactful programmes, such as wetlands mitigation credits, the set of opportunities to invest with impact and available instruments increase.[32] Such projects can be attractive to investors based on expectations of market-rate returns and low correlation with other investments.[33]

Impact Investing in Theory and Practice

Definitional Breadth and Investment Opportunities

Impact investing strategies target financial returns, which can range from capital preservation to market-competitive, and focus on a spectrum of social and environmental outcomes depending on sector, theory of change, implementation strategy and targeted beneficiaries.

While private equity and debt investments provide a more direct connection between investor's capital and impact creation, public equity and debt strategies can also help tackle global sustainability challenges. In recent years, the investment opportunity set and number of intermediaries in impact investing have increased, allowing for the creation of diversified impact portfolios with investments across asset classes that satisfy investors' risk and return requirements, in addition to generating positive social and environmental impact.

As with any investment approach, the success of impact investors can vary depending on factors such as investing experience and track record. Additionally, impact investors may face challenges due to real or perceived risks inherent to any innovative sector.

As impact investing is an approach, it can be applied across asset classes and risk-adjusted return targets in diverse and numerable ways. Common impact themes for impact investments include: community development, small business finance, health and wellness, education, microfinance and financial inclusion, sustainable consumer products and fair trade, natural resources and conservation, renewable energy and climate change, and sustainable agriculture and development.

Below are examples of impact investments across asset classes and impact themes:

Cash/cash equivalents

Investments of cash assets (such as certificates of deposit, savings accounts and money market accounts) into community banks and local financial institutions that make investments specifically into organizations that are intentionally seeking social or environmental objectives.

For example, Triodos Bank offers a range of liquid offerings to individual, business and institutional customers and "only lends to and invests in organizations that benefit people and the environment".[34]

Fixed income

Bonds with maturities ranging from short term (less than one year) to long term (five to more than 30 years) issued by governments, corporations or financial institutions that result in capital flow to impact enterprises or projects that address social or environmental challenges.

These include traditional and untraditional bond structures. The International Finance Corporation (IFC)'s green bond, an example of a traditional bond structure, is a $1 billion, three-year, AAA rated green bond with an interest rate set at three-year US treasury rates. The IFC uses green bonds to finance projects that result in reduced greenhouse gas emissions in developing countries.[35] In Michigan, the LIHTC (Long Term Housing Tax Credit) programme is an investment vehicle of $20 million annually intended to increase and preserve affordable rental housing. The programme permits corporations, banking institutions and individual investors in affordable rental housing to claim a credit annually against their tax liability for a period of 10 years.[36]

In December 2013, Threadneedle Investments and Big Issue Invest in the UK launched a £15 million social investment partnership to create the first FCA-registered diversified social bond fund in the UK market. The fund offers daily liquidity and anticipates generating financial returns in line with UK corporate bonds. The investment policy of the fund is to maximize exposure to socially beneficial activities.[37]

Investment funds (private equity and venture capital)

Investments made into third-party managed funds that make debt and equity investments into impact enterprises.

Private equity is the most common investment instrument used by impact investment funds. There are over 300 impact investment funds listed in ImpactBase, which presents offerings across asset classes, sectors and geographies. For example, LeapFrog Investments makes equity investments into impact enterprises that provide financial services to low-income populations. It has diverse investors, including large-scale institutional investors (e.g. TIAA-CREF), development financial institutions (e.g. IFC), investment banks (e.g. JP Morgan) and philanthropic investment firms (e.g. Omidyar Network).[38]

Public equities

Investments made into impact enterprises that are publically traded.

Given the early stage of the sector, few publically listed organizations exist that intentionally seek and measure social outcomes in addition to profits; however, notable exceptions do exist. London's Social Stock Exchange lists 11 publically listed companies that meet its criteria to be considered a "social impact business".[39] Although the number of publically listed impact enterprises is currently quite small, investors will have greater ability to find liquid trading opportunities of impact enterprises as retail demand increases.

Real estate

Investments made into sustainably managed properties, or properties currently in development in regeneration areas or among low-income populations, and in which social and environmental objectives are intentionally sought, such as smart growth, green buildings, urban regeneration and affordable housing.

For example, Vital Capital Fund and its local partner Kora[40] have committed roughly $200 million to build over 40,000 affordable houses in six provinces throughout Angola. The investment in Kora seeks to not only provide affordable housing units for the local population, but also to provide the full spectrum of necessary elements for vibrant community life, such as clean water, sanitation, power, education, social services, recreational facilities, green space, health services and more. These combine for better employment opportunities, cohesion and empowerment in an integrated urban community environment. With a clear understanding of the local cultural, economic, social and environmental requirements, Kora is now delivering sustainable cities for more than 240,000 people while also earning attractive returns for Vital's investors.

Infrastructure

Investments into the facilities and structures required for the effective operation of an economy and society, usually involving the provision of essential physical structures and services to populations at the bottom of the economic pyramid.

For example, with financing from a group of investors and the Kenyan government, the AfDB financed a €115 million investment in wind power in Kenya's Lake Turkana region. The project provides clean energy, reduces energy costs to consumers and connects landlocked regions to the rest of the country through improved infrastructure.[41] Impact investments in infrastructure appeal to institutional investors given the size and scale often associated with these transactions.

Other real assets

Identifiable and tangible assets, whose value is derived from physical properties, managed to produce long-term value to society and the environment, as assets are not depleted or damaged, such as sustainable forestry and agriculture.

For example, Equilibrium Capital invests exclusively in real assets (e.g. croplands, sustainable forestry, agricultural and food waste). The firm applies a "sustainable alpha" strategy in which assets are stewarded over the long term and considerations across the entire ecosystem (e.g. community and environment) are included in the investment decision-making process.[42]

Direct equity and debt/venture capital

Financing a for-profit company that generates a social or environmental benefit (e.g. social venture capital, private equity and debt).

Bridges Ventures is a private sector, mission-driven investment company that specializes in funds that can deliver financial returns and make a positive social or environmental impact. In late 2002, Bridges Ventures invested £125,000 of early-stage capital in Simply Switch, an online and telephone-based provider of comparative information for utility suppliers. Follow-on investments resulted in a total commitment of £345,000. Simply Switch was sold to The Daily Mail and General Trust for £22 million in 2006, returning £7.5 million to Bridges Ventures and resulting in a money multiplier of 22 times and an IRR of 165% to investors. By being the first provider to offer its service both online and over the telephone, Simply Switch made it easier for those without resources to go online to save money on their bills. Additionally, it created 80 new jobs in a Bridges Ventures target area and helped raise £500,000 for charities.[43]

Remaining asset classes

Commodities and hedge funds.

Commodities involve investments made into basic resources that are used in the production of other goods and services. While opportunities may exist for trading of sustainably produced commodities, it is unlikely to occur in the near future. Hedge funds involve complex investment strategies of publically traded companies; given the limited number of public listings of impact enterprises, there are limited opportunities for hedge funds in impact investing.

Layed investment structures[44]

Innovative structures, often hybrid investment products that offer tailored investment opportunities to investors with different risk, return and impact expectations.

For example, the California FreshWorks Fund is a public-private partnership loan fund which finances grocery stores and fresh food retailers in underserved communities in California. From the fund's $125 million loan pool, $100 million was raised from banks and insurance companies and allocated to a senior debt tranche, while $25 million was raised from a group of mission-driven investors and allocated to a subordinated debt tranche. Additionally, $7.5 million in grants has funded a first-loss reserve. Senior lenders are secured by collateral of the underlying loans from the FreshWorks Fund.[45]

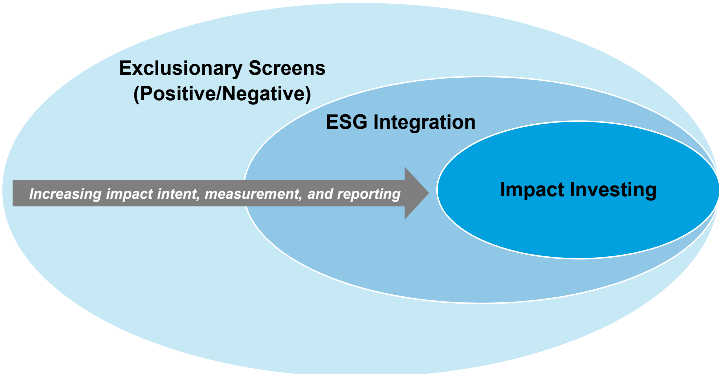
Impact Investing within the Context of Sustainable and Responsible Investing

While the focus of this report is on impact investing, there are several related investment approaches within the "investing with impact family" that may be of interest to family offices interested in incorporating impact into their wealth preservation and wealth growth strategies, including sustainable investing and responsible investing. This includes:

- Exclusionary investment screens (both positive and negative)
- Systematic and explicit integration of environmental, social and governance (ESG) factors into traditional financial analysis
- Impact investing which intentionally seeks to create financial return as well as positive social and/or environment impact that is actively measured

One way to relate these approaches to one another is to consider them progressively, incorporating sustainable and responsible investing themes in a more active fashion. For example, the integration of ESG factors into investment decisions may implicitly reflect a screening for particularly desirable/undesirable industries or geographies. Similarly, impact investments may implicitly reflect ESG factors in addition to the fact that impact investments intentionally target social or environmental outcomes. It should be noted that an investor can utilize any one of these approaches without explicitly engaging in the others. Figure 1 below provides a simplified visualization of how these approaches fit together.

Figure 1: Sustainable, responsible and impact investing approaches

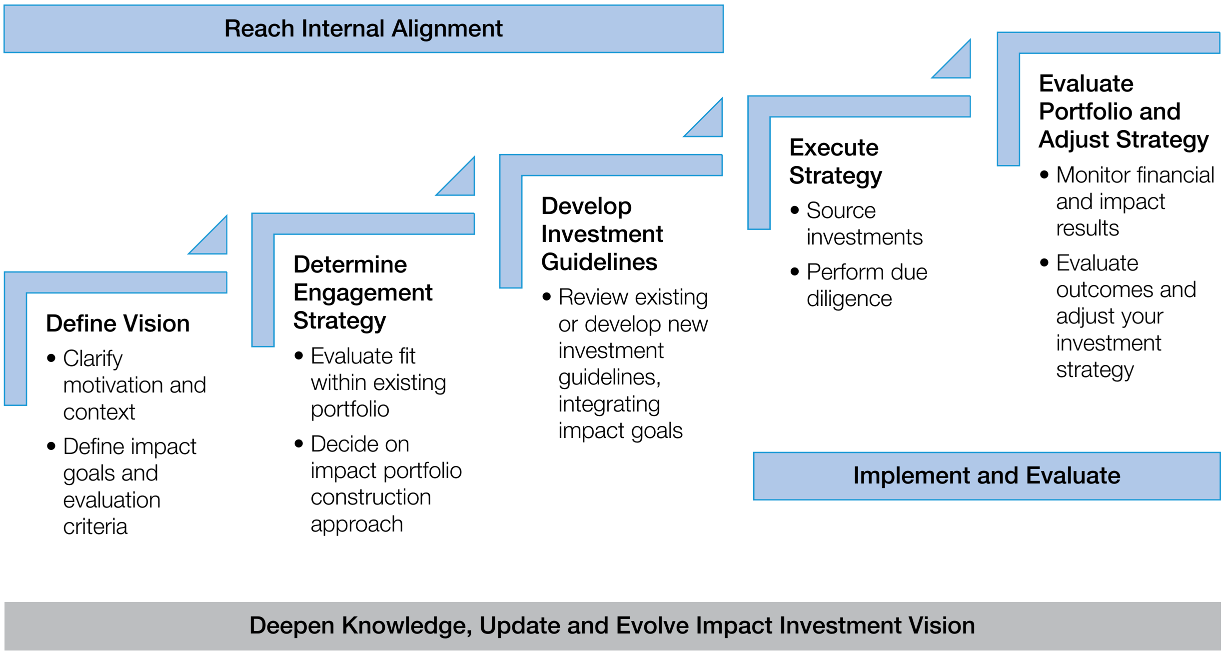


Interested investors should begin to engage in some capacity, re-evaluate, assess different strategies and course-correct based on experience and developments in the overall sphere of impact investing and in the investor's unique circumstances. Responsible and sustainable strategies can be used to increase overall portfolio impact *(see "Performing due diligence in an impact portfolio" on page 17)*.

All approaches within the sustainable, responsible and impact investing universe have merit and can have a positive impact. Moreover, experience in any of these approaches may be an "on ramp" towards future additional engagement with other approaches in sustainable, responsible and impact investing.

Charting the Course for Your Family Office into Impact Investing

Each family office begins from a unique starting point and has different goals. Accordingly, each family office's path into impact investing will differ. The following framework may be helpful for family offices interested in customizing their engagement with impact investing. For some, following all five steps attentively can be a meaningful approach; for others these steps can serve as guideposts as they chart their own course.



Step 1: Define vision
Define a clear vision for impact investing. The family must align on its values, its desired future legacy and impact and financial goals for what it wants to achieve through the family office. Assessing the internal context is important to understand the constraints as well as opportunities for its impact investing strategy.

Step 2: Determine engagement strategy
Determine how to engage with impact investing. It is ambitious for a family office to begin by reallocating a significant portion of assets to impact investing; a more gradual and iterative process is often preferred after examining internal capabilities, considering available resources, knowledge and expertise.

Step 3: Develop investment guidelines
Develop investment guidelines. Formalized investment guidelines allow the family office to align family members' interests and values and help to ensure a smooth execution of the strategy. If an investment policy statement already exists, the family office can update it with impact goals and evaluation criteria.

Step 4: Execute investment strategy
Execute the investment strategy. Deploy capital based upon the investment guidelines and impact portfolio construction model. This section provides insights on different portfolio construction models as well as investment sourcing, due diligence and monitoring.

Step 5: Evaluate portfolio and adjust strategy
Evaluate the portfolio on a regular basis and adjust strategy. While executing the investment strategy, family offices should review periodically the successes and setbacks and refine the investment guidelines accordingly. Clear and defined impact and portfolio goals upfront will facilitate the evaluation process, whether it is through third-party assessments or periodic internal review. Based on the results of the evaluation, the family office can refine its investment strategy with updated impact and portfolio goals.

Guiding Principles

Some commonly cited guiding principles to consider when beginning on the impact investing journey:

No one-size-fits-all approach
To navigate the complexity of impact investing, investors should define an approach that suits their motivations and unique context.

Avoid analysis paralysis
Philosophical debates about what counts as impact investment versus other types of responsible investment will likely continue as the field matures. The key is to engage in some capacity at first and then course-correct and re-evaluate the strategy over time.

Work with and around challenges
Recognize and acknowledge challenges, determine which ones are show-stoppers and which ones can be creatively addressed. Making this determination will help investors remain action-oriented.

Willingness to shape the opportunity
Similar to other financial innovations, success in impact investing often requires that investors think multiple steps ahead of the current landscape. Some investors choose to take an active role in developing the marketplace. If this is done well, early investors will be well-positioned to benefit from future growth in impact investing activity.

Step 1: Define Vision

As there is no one-size-fits-all approach, building out and executing an impact investing strategy requires patience, discipline and focus. To begin with, it is helpful for a family office to define a vision for impact investing which takes into consideration:

- The motivations for pursuing impact investing
- The structure, size and internal context of the family offices
- The goals and approaches which can align what is desired with what is possible

These three components will help align the family office's vision and craft the approaches necessary to move forward with engaging in impact investing. The clarifying questions below are designed to help facilitate this process; not all questions will be relevant for all family offices.

Clarify motivation

Some families are clear on their shared values and desired future legacy; this is often reflected in past or current philanthropic commitments or it can relate to aspects of their family identity such as their family business.[46] In other cases, the family office may benefit from engaging all of the decision-makers in a discussion on their values, interests and constraints. Having an internal champion – often someone who has high levels of trust and influence across family members – may be a strategic way to begin the discussion.

- What societal issues are most important to your family? What problems are you passionate about resolving? Are there impact themes or geographic regions that align with your values or core business?
- What are your future generation needs in terms of ensuring capital preservation as well as the future world you want your children to enjoy? What legacy do you want to leave to next generations?
- What societal issues are you best positioned to address given your time horizon, investable assets and expertise?
- In what ways have philanthropic efforts been effective and limited (e.g. scale, market orientation)? How can impact investing be an opportunity to engage the next generation on values?
- What is your perspective on the role of philanthropy and investment? Would you prefer to maximize returns within your investments than donate philanthropically to causes you support, or prefer to find investments that blend financial returns with impact?

Clarify context

Each family office has a unique structure and contextual factors influencing its appetite to engage in impact investing, including how many generations it spans, whether the patriarch of the family is alive or not, the size of its assets under management (or advisement), the level of in-house expertise, its liquidity requirements, its current asset allocation and its appetite for risk and/or innovative approaches.

- Do you need to grow your assets or just preserve your wealth? What are your return and risk expectations for each asset class? What is your current portfolio allocation framework?
- How much discretionary capital do you have at your disposal? Where and across what entities is the capital held and who are the stakeholders for different pools of capital?
- How comfortable are you making long-term investments? What are your capital needs on a short-term and long-term basis?
- What is your capital market outlook in terms of investment risks and opportunities?
- Are there operational constraints driving minimum investment size restrictions and the related economics of due diligence? Are there solutions available to diminish such barriers?
- Does the family already devote resources to social causes? How are those managed? Do you currently allocate through intermediaries/fund managers or a combination of fund managers and direct investments?

- Do you have the capacity to screen direct investments internally? What is your level of experience and stock of intellectual capital in making impact investments? Do you have the required skills and knowledge to integrate impact strategies in your existing processes?
- Are you willing to co-invest with other family offices on impact investing deals? What will be the family members' level of engagement in the investment process (e.g. how hands-on do you expect to be with investment selection)?

Craft a vision

Once the motivations for engaging with impact investing are clarified and the internal context in which the family office is operating is understood, the family office can craft its vision for how it wants to engage with impact investing. The vision is the articulation for why the family office decided to and continues to have an intentional strategy of engagement in impact investing. Identifying outcomes and specific targets early on will help evaluate performance in later stages.

- How can impact investing fit with the family office's current and long-term financial goals and shared values?
- What considerations, trade-offs and constraints is the family office willing or not willing to accept?
- What does the family hope the long-term impact of engaging with impact investing will be for family members, the broader community and future generations?

Step 2: Determine Engagement Strategy

Once the family office's vision for impact investing is set, how should the family office get started?

Deepen knowledge of impact investing

The key to designing a family office's engagement strategy with impact investing is to learn more about what others have done and then decide what to emulate or to do differently. Approaches to learning can include:

- Attend impact investing conferences to hear from experts and to build a network of experienced contacts
- Learn through desktop research and coursework[47]
- Participate in knowledge-sharing networks and collaboration/ co-investment platforms[48]
- Meet with other family offices engaged in impact investing to share ideas and due diligence

Refer to Appendix B for a list of educational resources, including publications, investor networks and forums.

Reach alignment within the family

Complex family dynamics may prevent family offices from reaching a consensus and mandate that would allow them to move forward. The following suggestions can be helpful in addressing the issue:

- *Understand context:* Given the financial goals and past performance of the portfolio, understand how impact investing would fit into the current investment framework and portfolio construction before presenting it to other stakeholders.
- *Initiate conservatively:* Start with investments which are less risky, liquid and provide stable returns. Investments which can be analysed with the same rigor of existing investments and by existing staff or financial advisers may increase the receptiveness among sceptics. These investments could include community development bonds, microfinance and real assets.
- *Learn by doing:* Many family offices get stuck trying to agree on a specific percentage for a target allocation to impact investments. Instead, begin the discussion by presenting decision-makers with concrete deals and small pilot investments. This approach is more likely to gradually gain support.
- *Collaborate:* Join a peer group and /or make friends with like-minded individuals for support (See resource list for impact investing networks in Appendix B).
- *Lead from strength:* In many cases, identifying the most influential member(s) and getting support can make it easier to gain consensus from the group and from the advisers who support them.
- *Provide open forum for communications:* Support open communication across generations, ensuring stakeholders collectively outline and share both financial and social goals; this can be done through regular annual or semi-annual meetings or retreats with a defined agenda to discuss family values and investments and review progress against stated goals (see www.worth.com for sample agenda).
- *Engage facilitators:* A trusted third party can help the diverse family members reach agreement and reduce pressure on the internal stakeholders to be unbiased mediators. Often, historic family dynamics and interaction patterns can emerge during discussions. Independent facilitators can help ensure all voices get heard fairly and the final outcomes reflect the shared interests and values of the family members.

Work with advisers

Family offices vary widely on the level of in-house expertise and capacity they have and/or outsourced support they need. Approximately one-third of single family offices reported they lacked sufficient in-house investment expertise.[49] As many family offices are designed to have lean overhead, external advisers can play a strategic role in complimenting and augmenting the family office's existing internal capabilities.

There are four ways that family offices may rely on external support. First, impact advisers can complement the expertise and guidance of traditional investment advisers. Since impact investing is a nascent sector, traditionally trained advisers may lack the expertise and experience to evaluate innovative impact strategies. Advisers can identify impact themes and facilitate investment opportunities aligned with the family office's target impact and overall investment guidelines. Alternatively, advisers can work with the family office's investment staff to identify impact opportunities within particular asset classes. For family offices that do not have in-house investment staff, there are consultancies and firms that provide full support.

Second, if the family decides to carve out a portion of its portfolio for impact investing, it can assign that carve-out to a specialized impact investment advisory firm or fund manager. Third, a family office (often one that is already working with an outsourced adviser) can switch advisers to work with a firm that specializes in impact strategies (either solely or in addition to traditional investing). Fourth, due to the escalating cost of in-housing financial expertise over the last decade, a trend towards single family office staffing focusing on administrative functions while outsourcing CIO functions, has emerged. A family might work with an outsourced CIO who has impact investment expertise to develop a transition strategy.

The process of selecting an adviser can be complex. Here are some commonly shared tips:

- To find the right adviser, assess upfront the fit between the family office and adviser on:
  - Value system, desired impact legacy and overall worldview
  - Existing capabilities and skillsets (e.g. investment management and impact investing expertise)
  - Networks and relationships for sourcing deal flow (private equity and debt investments, relationships with other fund managers and family offices for co-investment opportunities)
  - Cultural fit (e.g. impatient optimist vs deliberated pragmatist)
  - Communication style (regularity, extensiveness and format of communicating)
  - Expectations about how hands-on the family office would like to be with the investment process
  - Perspectives on risk factors of the portfolio and macro-trends are aligned
- Ensure transparent cost structure, corresponding to the set of services required
- Ensure the adviser does not have conflicts of interest (e.g. acting as an adviser both to investees trying to raise funds and investors seeking objective advice on deal flow)

Many of the above considerations can serve as guidance in drafting the impact investing adviser request for proposal (RFP).[50]

Spotlight: Institutionalized resistance

For many investors, gaining internal alignment among family members is only the first hurdle. Unfortunately, a second hurdle might arise when their adviser or CIO (either internal or outsourced) is conservative in incorporating innovative strategies, such as impact investing. This resistance may spring from either a perceived higher risk of impact investments or a lack of financial incentive for advisers to provide the level of customization and innovation that impact investing requires. As a result, some investors have switched advisers to ones who are willing and able to accommodate their interest in incorporating impact investing into their investment strategy.

In 2014, the Rockefeller Brothers Fund (RBF) ended a seven-year relationship with their outsourced chief investment officer (OCIO) because the OCIO firm's business model (100% co-mingled funds of more than a dozen clients) did not provide sufficient flexibility for RBF to make the desired progress. Through a competitive search process, RBF hired a new OCIO, an independent investment services firm, to align their investment goals with their social mission.

RBF aims to allocate 10% of assets to impact investments and hopes to exceed this goal over a multi-year period. The investments will be in clean energy and other sectors that are aligned with other elements of its mission and programs. The investments must have a measurable impact as well as market-rate risk and return characteristics, preserving the value of the endowment. The OCIO firm hired an impact-focused consulting firm to assist in this transition. This structure allows RBF to leverage the experience and track record of a diverse team of investment professionals in a more affordable way than hiring an internal CIO.[51]

Evaluate fit within existing portfolio

As with all change, key decision-makers need to understand the range, likelihood and effort involved in the opportunities as well as the challenges. For family offices new to impact investing, internal champions should present other family members with information, including examples of impact deals and lists of their peers who have made impact investments. The family office can assess how these investments will fit into current asset allocation framework and the portfolio's risk/return.[52] Showing decision-makers impact investing opportunities that meet the family office's financial return requirements and risk appetite can be a solid approach to starting the conversation.

According to a 2013 *Financial Times* survey of family offices, 15% of respondents made investments with impact prior to 2000 while 29% of respondents made impact investments after 2010 (several years after the term impact investing was coined). Of 125 single family offices, multifamily offices and family-backed foundations surveyed, 68% consider some portion of their portfolios to be in impact investments. In addition, two-thirds of single family offices that are engaged in philanthropy discuss budget allocations to impact investing while 85% of multifamily offices have at some point engaged in such discussions with their clients. Yet few have well thought-out strategies for engaging in impact investing.[53]

For family offices that have made investments with impact but not as part of an intentional strategy, it may be helpful to perform a retroactive tagging exercise of prior investments to identify areas of positive social and environmental impact. This exercise can help to satisfy sceptical family members who fear that targeting a positive impact will negatively affect their portfolio's risk/return profile. For example, the ABC family retroactively screened their portfolio and learned that as part of their larger fixed income portfolio, they had been investing in bonds that support building schools in Virginia. They then asked their bond manager to expand their allocation to similar bonds, which not only increased their allocation to impact investing but also left their portfolio's risk profile unchanged.

Four approaches to engage in impact investing

There are several structures that family offices have implemented to engage in impact investing. Below are four examples. Often, a combination of these approaches is used to meet the individual goals of each investor.[54] See Appendix A for details on motivation and context, potential risks and examples for each approach.

Test the waters
Many family offices, once committed to an impact investing strategy, can spend inordinate time searching for and designing the perfect, first move; yet perfect can easily become the impediment to action. Starting small or co-investing with others is a recommendable strategy to "get your feet wet". It builds internal momentum for impact investing, helps refine the family office's preferences through learning by doing, and allows sceptical or risk-averse stakeholders to become comfortable with the new investment approach.

Approach A
Test the waters with a smaller portion of the portfolio by: making one-off investments and then gradually increasing allocation if things go well; using a donor-advised fund or family foundation to pilot impact investments; and allocating a portion of the portfolio to impact investing by creating a carve-out. In some cases, the carve-out is in the form of a separate legal entity managed by impact-driven family member(s); typically, a carve-out would be roughly 1-10% of the portfolio, and depending on the areas of success, it can be increased.

Approach B
Commit a part of the portfolio to high-impact investments in impact-focused companies or into funds; a common approach here is to make direct investments or private equity deals yourself and outsource public equity and debt investments. It is important to note that investing through funds adds a level of separation between investor and assets. Negotiating strong co-investment rights can offer a hands-on investor more direct exposure to investee companies. Pledge funds or pooled vehicles allow investing through a fund while being an active investor.

Approach C
Seed an investment vehicle either through backing an existing manager/management team with an established track record and specialization or through establishing a new investment team. This approach allows asset owners to leverage personal wealth and institutional capital to scale the market reach and impact of their investment. The advantage of backing an already existing team is that it can reduce the time and effort required to build a professional organization with an established investment track record thus accelerating fund-raising efforts.

Approach D
Integrated impact across the portfolio[55] – create a balanced impact portfolio by gradually overlaying impact across every asset class from public equities, fixed income to alternative and direct investments; a common approach here is to make direct investments or private equity/debt deals internally and outsource public equity and debt investments.[56]

Spotlight: Retroactive tagging

To determine how much of a portfolio is already generating impact, one can review each investment, evaluate it for its social and/or environmental return, and retroactively tag each investment. These investments can then serve as proof points to sceptical decision-makers about the financial viability of impact investments. Furthermore, such investments can inform decisions about where additional impact might be sought (e.g. asset class, geography, impact focus).

To start this process, it might be helpful to first identify commitments in sectors where investors tend to be socially motivated, such as agriculture, health, education, renewable energy, finance and housing for the poor, and water and sanitation. When conducting this retroactive tagging exercise, it is important to value quality of impact over quantity of potentially classifiable impact investments. To understand this sector and its role in your own portfolio, it is better to have an inventory of investments that are impact investments than to have a large number of ambiguous cases.

Each individual investment can be examined to determine whether at the time the investment decision was made, impact was a goal of the investment in the first place. This test of *intentionality* will be helpful if and when the family decides to engage with the impact investing sector. A number of sector-building initiatives use this test of intentionality to screen for impact investments that are then assessed on a number of dimensions, including risk/return characteristics and impact performance.

For more information, see http://reports.weforum.org/impact-investing-from-ideas-to-practice-pilots-to-strategy/3-3-evaluating-past-impactful-investments-to-create-a-future-impact-investing-strategy.

Step 3: Develop Investment Guidelines

The process of formally outlining the family office's guiding principles is valuable as it can help ensure family alignment while adding a level of accountability. A clear vision of impact areas and investment goals which balance the interests of various family members can make the wealth transfer to the next generation smoother. Regular communication with all the family decision-makers – through conference calls, emails, meetings and/or annual retreats – will ensure the family office's mission and vision remain relevant, actionable and accountable.

Formalized impact guidelines can take many forms – and not all involve a codified Investment Policy Statement (IPS). For example, a family office can create a mission statement or family constitution that expresses its values and theory of change. A comprehensive IPS typically includes the following elements: family mission, financial and impact goals, risk appetite (financial and "impact risk"), asset allocation targets, metrics (financial and impact), benchmarks and reporting details. An IPS should be dynamic and able to incorporate changes, especially as a family office refines its preferences over time and seeks to pursue investments that better reflect its values and needs.[57]

Step 4: Execute Investment Strategy

Determine an impact portfolio construction model
Whether a family office chooses a carve-out or an integrated approach, the asset allocation framework should be based on the impact objectives and traditional financial parameters such as risk tolerance, return objectives, liquidity profile and spending needs. The below impact portfolio construction models can serve as models, either to be adapted purely or as a blend of the two or three.[58]

Asset allocation-driven
Consider setting the asset allocation framework first and then overlaying it with impact investments when the impact theme is broad and the family office uses a traditional allocation model with moderate risk exposure. With some asset classes, such as public equities with many shareholders, the desired impact goals may be harder to achieve unless the family office becomes an activist investor or has significant influence through proxy voting. With more direct investing (i.e. private equity and real assets) there is more room to influence the investment decisions and manage for impact.[59]

See "Performing due diligence in an impact portfolio" on page 17 for tips on ensuring impact across asset classes.

Impact theme- or region-driven
Select impact themes first and then find opportunities to express them across asset classes when the impact theme is specific (cause-related, sector-focused or regionally concentrated). Key for a balanced portfolio is to focus on an impact theme broad enough (e.g. climate change mitigation) and not too narrow (e.g. sustainable forestry) so that it would be possible to reflect the impact theme across asset classes.

Focus on direct investing
When the family office has both desire and expertise to focus on a specific impact area, direct investing is an appropriate option. For many first-generation family offices that derived their wealth from a particular sector or geography, direct investing for impact and financial returns can be the best approach. Direct investments may include early-stage and angel investing, which are appropriate for those with expertise and experience in venture capital. Impact entrepreneurs often view family offices as both strategic partners who share their passion and as attractive, nimble investors. Yet for some family offices, early-stage investing may be too risky. Family offices should consider their risk preferences, liquidity needs and time horizons when making direct investments, especially when considering early-stage deals.

Spotlight: Deploying capital purposefully and innovatively

Family offices can build the impact investing sector by deploying their capital in the following ways:

Become a strategic partner with their investees.
Many family offices with sector, geographic or cause expertise can provide strategic advice and active guidance that improves the investee's operational strategy and business performance. Additionally, many family offices can gain greater control in their investments by investing in the general partner. Positioning themselves as an operational partner in a fund, family offices can gain access to deal flow that is usually reserved for private equity firms as well as receive discounted management and operational fees.

Provide seed financing in underserved and high-impact markets.
Seed capital is critical for new companies and funds, especially those that are located in places where venture capital and private equity do not often reach (e.g. sub-Saharan Africa). Family offices can play the role of being an anchor investor in companies or funds they believe will have a multiplied impact.

Deploy capital to build sector's infrastructure.
There are increased opportunities to invest in innovative vehicles, instruments and financing solutions such as commingling funds, social impact bonds or development impact bonds. Family offices can not only pave the way for other investors, but their investments can also de-risk the impact investing sector so other investors can engage.

Encourage others to participate in impact investing and form syndicates.
Family offices already active in impact investing can serve as mentors and encouraging voices for other family offices to make impact investments. This allows family offices to meet minimum investment requirement of many funds, have more operational control and access best in class managers.

A few important considerations in choosing your investment guidelines and portfolio construction models:

- *For family offices with the capacity to source and perform due diligence in-house*, consider narrowing the impact theme to save time and resources on due diligence.
- *For family offices with specific expertise*, consider narrowing the focus to that geographic region, sector or cause to ensure both procedural efficiencies and impact results.
- *For investment strategies with a narrow impact focus*, ensure the family office has the flexibility to see indirect but equally important ways to achieve the impact goal. For example, a family office interested in supporting early childhood nutrition among children ages 2-5 years old in rural New Mexico might find a lack of investment opportunities if the pre-defined parameters limit the options.[60] However, if the family office considers investments in maternal education and affordable supermarkets – and broadens its understanding of its impact target – it can have a larger impact.

Spotlight: Distinguishing perceived risk from real risk

Some investments that have a community-oriented or social focus are often labeled concessionary when they are not. For example, in the early 2000s, community development financial institutions were labeled concessionary given they served poorer households and delivered smaller loans at low interests rates and consequently had higher transaction costs. Yet during the financial crisis, these CDFIs had stronger balance sheets than traditional financial institutions and performed better financially – both on an absolute and risk-adjusted basis – than traditional banks. The CDFIs' strong governance and commitment to responsible stewardship in the community ended up benefiting investors. Likewise, many mainstream investors and advisers assign higher risk to impact investments today given the focus on impact. It is too early to conclude whether the impact investments considered concessionary today will produce above market or below market returns over the long run. For the time being, it is important to distinguish perceived risk from real risk.

Sourcing investments

Family offices have greater flexibility in their mandates than other investors (i.e. pension funds), allowing them to utilize a variety of strategies within their capital structure and to invest across asset classes. For more examples of impact investments across asset classes, see Appendix B and the Impact Assets Chart.[61]

Sourcing impact investments presents similar challenges to sourcing "traditional" investments – finding quality investing opportunities that fit a narrow geographic or thematic focus can be time and effort intensive. Syndication of impact investments with other like-minded investors can help defray administrative costs, facilitate larger investments and offer access to better deal flow. Ways to do this include:

- Actively survey the universe of investable deals (news articles, press releases, conferences) as well as develop networks with experts in the markets and sectors that are of interest to the family office
- Develop relationships with other family offices and join networks of family offices to explore co-investment opportunities
- Explore opportunities listed on crowd-funding platforms (current or historic raises where the company may be interested in follow-on funding)
- Rely on impact investment advisors and consultants
- Explore co-investment opportunities with public sector, other types of private investors and foundations (e.g. social impact bonds and commingling funds)[62]

See Appendix B for a listing of web-based impact investment platforms and forums as well as conferences.
See Appendix C for sample investment opportunities across asset classes.

Performing due diligence in an impact portfolio

As a greater number and wider spectrum of impact investment opportunities continue to become available to investors, it is anticipated that all asset classes will be capable of delivering risk-adjusted, financially competitive and mission-aligned returns to investors.

In the context of a complete portfolio approach to impact investing, every potential investment should be evaluated in terms of its contribution to the total portfolio. Position levels should be monitored relative to the investment policy, but to the extent possible, investors should remain flexible and nimble when faced with changing conditions and in light of new impact information. Investors need to balance the impact desired with the impact available. In many but not all cases, it is possible to achieve a satisfactory balance.

The KL Felicitas Foundation mapped each investment to the foundation's overall asset allocation targets with attention to any overexposure within a particular theme, sector, manager or company. Sometimes, when the desired exposure could not be matched with acceptable impact investments, the foundation allocated capital to cash, cash equivalents or short-term debt. As the impact marketplace matures across asset classes, the incidence of "overexposure" will become less likely. Below are insights and lessons learned by the foundation for performing due diligence on impact investments across asset classes.[63]

Due diligence for public strategies
There are three main categories, listed in order of lowest to highest impact, for public equities and debt:

1. **Negative screening (responsible):** Investors may opt to apply negative screens to exclude investments that create harmful impact such as tobacco, firearms or alcohol. The use of screens can reduce the efficiency of portfolios and may entail certain risk/return trade-offs.
2. **Positive screening (sustainable):** Investors can include criteria for positive impact (e.g. incorporating ESG criteria or sustainability considerations) into their selection of fund managers and investments to ensure their investments do not only create a negative or neutral impact, but also a positive impact.
3. **Social or environmental themes (thematic):** Thematic strategies focus on a particular social or environmental trend or sector theme (e.g. digital divide). Managers identify the most progressive companies (or other issuers) with strong ESG performance within a given theme and then screen for financial performance and investment track record. Impact investors should analyse not only the returns of a strategy, but also understand the underlying drivers of returns and risk, including the factors to which each strategy is exposed. As investors become more comfortable with the impact marketplace, they can begin to think about "impact allocations" – allocating their investments optimally across various impact approaches and target themes – in addition to asset and risk allocations.

An important step in investing in public equities for impact is being able to change corporate behaviour through shareholder engagement and proxy voting. Growing evidence shows that proxy voting and shareholder engagement can directly influence corporate and government behaviour. Institutional investors, third-party asset managers and shareholder organizations are leading this work (see Appendix B for examples of service providers who support this activity).

Due diligence for private strategies
For investors for investors able to access private market investments, alternative strategies are critical components of an investor's diversified asset allocation strategies. Private investments can provide exposure to direct impact in themes important to investors such as clean energy and technology, community development, sustainable forestry, sustainable ranch land and financial services for base of the pyramid (BoP) communities.[64]

Just as in the public markets, private investments require extensive financial, impact and operational due diligence. The due diligence process is iterative and non-linear: integrating impact criteria into the investment process can surface new quantitative and qualitative data points that enhance the quality of due diligence and ongoing monitoring.

Given the impact investing sector is nascent and the track record of many impact companies and fund managers is short, asset owners can ensure good governance by taking an active role in the investee company (a board position or building a close relationship with senior management). As with traditional investments, the management team is often the key determinant of success in the impact investments.

There is sometimes a trade-off between direct investing in the projects or companies that an impact investor finds most appealing and maintaining a diversified portfolio. Not all investors will be able to achieve adequate diversification through private investments by investing with single managers or in deals individually. For such investors, multi-manager vehicles can provide options for broader exposure.

Spotlight: Direct vs public equity investments

Within impact investing, many practitioners are biased towards direct investing based on the assumption that direct investing offers more impact. Yet the operational risks of such investments are also greater than investing in publically traded companies. Additionally, publically traded companies have the potential to create impact on a much larger scale. For example, Unilever has had a global impact on energy conservation and waste reduction through modifying its operations.[65]

In some cases, an investment in a publically traded non-impact business can have a greater impact than a private direct investment in social business if the investment in the public company both results in a disproportionately greater scaling of positive impact and there is no off-setting negative impact (e.g. unfair labour practices or harmful business operations such as deforestation that have large negative impact).

Managing risk in impact portfolios

There are several risk factors that impact investors should be especially aware of when performing impact due diligence. These include:[66]

- *Liquidity risk* – Many direct impact investment opportunities are long-term investments without a well-defined exit strategy.
- *Fund raising risk* – Managers may be slow in raising and investing capital due to early stage constraints of impact investing market.
- *Manager risk* – Many managers in impact investing lack track records, have smaller asset bases and portfolio breadth, and higher turnover due to lower compensations.
- *Measurement and reporting risk* – Measuring impact is challenging. If not done well, it can lead to inaccurate assessment.
- *Impact risk* – The investment may not produce the desired impact in the end.[67]

Similar to traditional investments, impact investors should remain aware of potential risks, so that the appropriate steps can be taken to mitigate or address pitfalls.[68]

Step 5: Evaluate Portfolio and Adjust Investment Strategy

Monitor impact investments

Once investments are selected, the family office can agree on which metrics should be tracked, measured and reported on an annual or semi-annual basis. Evaluation criteria can be laid out upfront in the investment policy, but they will also evolve as investments are made, monitored and the impact goals are refined.

Actively measuring impact involves the following steps:

- Use or create a baseline of standardized indicators; overlay additional proprietary metrics specific to the impact strategy[69]
- To minimize the burden on the investee, choose a few relevant indicators and set up systems to streamline the process of data collection and analysis (this can be done internally or outsourced)
- Obtain independent impact assessments from specialist third-party service providers
- Regularly assess the impact performance of investments relative to the impact targets/objectives

Measuring impact across a diverse portfolio is challenging. Determining a way to integrate financial, social and environmental returns in a way that facilitates data collection and simplifies reporting has become the “holy grail” in impact measurement. Common formats for impact reporting include scorecards and dashboards, which can be used for screening investments, managing performance and evaluation. Once a reporting system is in place, it becomes easier to track trends, identify patterns and assess potential risks.[70] If a family office does not have the capacity to monitor impact in-house, external consultancies abound.

See Appendix B for resources on impact measurement, including metrics and technological platforms.

Adjust strategy

An impact investing strategy should not be static, but rather regularly refined given the family offices interests, needs and constraints, and the evolving impact landscape. Monitoring and evaluation not only helps ensure the investment outcomes are aligned with the values and interests, but also can provide valuable learning opportunities for the future strategy. Given that impact takes time to mature, it is important to be patient and to distinguish proxies and outcomes from long-run impact and multi-generational legacy.

Impact is relative to the problem being addressed. What was an impact investment 20 years ago might not be considered an impact investment today (e.g. some assert this is the case with microfinance) and what is an impact investment today (e.g. off-grid energy access or computer literacy in sub-Saharan Africa) might not be an impact investment in a decade. Family offices should adjust their strategy accordingly, especially when their previous impact investments may have had strong results and significantly reduced the problem.

Conclusion: Unique Positioning of Family Offices to Grow the Impact Investing Sector

Impact investing is an emerging investment approach that can help family offices align their values with their financial goals. Family offices are uniquely positioned to play a catalytic role in the impact investing sector. Yet impact investing might not be a suitable strategy for all family offices.

The decision for a family office to create an impact investing strategy is not one to take lightly. Alignment among family members on values and needs from the family wealth as well as how the vision for impact investing would fit with the family's long-term legacy are crucial. For the strategy to be sustainable, the family must be clear on return expectations as well as short-term and long-term capital needs.

As each family office is different, there is no one-fits-all approach. The World Economic Forum hopes that the approaches outlined in this guide will be useful and inspirational for family offices eager to include impact investing into their family office strategy.

For those family offices that decide to engage meaningfully with impact investing as the sector matures, the opportunities to create multi-dimensional wealth (financial, societal impact and long-term legacy) will be worthwhile.

For more on the World Economic Forum's work on impact investing, visit http://www.weforum.org/projects/mainstreaming-sustainable-and-impact-investing

Appendices

Appendix A – Potential Approaches to Structuring Impact Investing Strategy

Approach A

Description: Test the waters with a smaller portion of the portfolio by: making one-off investments and then gradually increasing allocation if things go well; using a donor-advised fund or family foundation to pilot impact investments; and allocating a portion of the portfolio to impact investing by creating a carve-out. In some cases, the carve-out is in the form of a separate legal entity managed by impact-driven family member(s); typically, a carve-out would be roughly 1-10% of the portfolio, and depending on the areas of success, it can be increased.

Motivation and context: This approach allows one to gain experience, better define impact areas and gradually achieve internal buy-in by educating other stakeholders in the process of making investments. It could be especially relevant for multi-generational family offices with complex family dynamics and decision-making process, those who lack expertise in impact investing or investing in general, and those who lack well-defined impact theme.

Areas of risk: Smaller asset base of a carve-out can lead to a lower degree of diversification and a higher investment cost; lack of a clearly defined strategy and expertise may also negatively affect performance of the smaller portion of the portfolio.

Example: The HRK Foundation started impact investing with an initial investment into a global public equity manager based in London. After this turned out to be a positive experience, HRK committed 20% of its foundation assets to impact investing seeking investments across both public and private strategies.[71] When the Kellogg Foundation decided to pursue its mission-oriented investment strategy, they first allocated $100 million of the endowment's assets to impact investing to test different strategies (from community bank deposits to direct venture capital deals) and learn from their experience.[72]

Approach B

Description: Commit a part of the portfolio to high-impact investments in impact-focused companies or into funds; a common approach here is to make direct investments or private equity deals yourself and outsource public equity and debt investments. It is important to note that investing through funds adds a level of separation between investor and assets. Negotiating strong co-investment rights can offer a hand-on investor more direct exposure to investee companies. Pledge funds or pooled vehicles allow one to invest in a fund while being an active investor.

Motivation and context: This approach is particularly relevant for family offices seeking a more direct engagement and are passionate about a specific issue. In this case, it is helpful to have venture capital or private equity expertise and the capacity to take on a high-touch, time-intensive investment. When allocating to these longer term illiquid investments, the investor needs to carefully assess its liquidity requirements for the next 3-5 years and degree to which these investments may change a risk profile of the entire portfolio.

Areas of risk: Operating under misconception that direct investments necessarily create greater impact than investments in publicly traded companies, increasing risk profile of the overall portfolio due to higher risk profile of direct investment, lack of liquidity, and high level of commitment in terms of time and effort.

Example: New Island Capital Management is a multi-family office with a mission to help its clients to invest patient capital at scale to achieve risk-adjusted financial returns and transform the way natural resources are used, businesses are built and communities thrive. New Island invests globally with a focus on the core themes of sustainable agriculture, communities, alternative energy and the environment. The investments have long-term horizon and span three asset classes – liquid assets, real assets and private equity. New Island monitors the investments and engages with investee companies and third-party managers to help drive financial and impact performance.[73]

Approach C

Description: Seed an investment vehicle either through backing an existing manager/management team with an established track record and specialization or through establishing a new investment team.

Motivation and context: This approach allows asset owners to leverage personal wealth and institutional capital to scale the market reach and impact of their investment. Backing an already existing team provides direct exposure to an established platform and a professional investment team while reducing the time and effort required to build a professional organization with an established investment track record. However, buying into an already existing team may be limiting in terms of control over investment strategy. Families often form funds when a family member would like to take an active investment management role. Then they bring seed capital and investment management resources.

Areas of risk: Operational risks similar to any investment company.

Example: Family ABC runs a multi-generational family business in the construction industry.

Over 40% of energy consumption and carbon emissions relate to lighting, heating and cooling buildings. The effects of increasing energy consumption and prices during the last decade precipitated the family's initial interest to focus on energy efficiency as a commercially attractive investment theme, while creating a long-term sustainable social impact (i.e. in this particular case carbon reduction).

"Company A" is a London-based private equity investment management firm specializing in companies that operate in the areas of energy efficiency, waste, water and energy generation, such as recycling electronic waste, water purification treatment and construction materials. Prior to raising the first institutional fund, the company built a strong proprietary investment track record, allowing the company to attract institutional capital. In 2008, "family ABC" acquired a strategic holding in Company A, while providing the seed capital for Company A's first institutional fund. To date, Company A invested over €150 million in a portfolio of 16 companies, which it actively manages. With this track record, the company is in the process of raising €300 million for its second fund from institutional investors, corporates, family offices and ultra-high-net-worth individuals.

Approach D

Description: Integrating impact across the portfolio[74] – creating a balanced portfolio where over time impact is overlaid across every asset class from public equities and fixed income to alternative and direct investments. A common approach here is to make direct investments or private equity deals internally and outsource public equity and debt investments. This approach will include impact investing as well as responsible and sustainable investing.

Motivation and context: This approach is relevant for everyone who would like to align their overall wealth with their values. It is easier to adopt this approach as a starting point for highly-driven family offices with a lean structure and decision-making process. Having a broad impact theme will help create a balanced portfolio across asset classes (it is still possible to have a narrow impact theme in the direct investment allocation). The approach required a high degree of engagement in the investment process.

Areas of risk: Inability to achieve desired impact across asset classes due to lack of investment opportunities in a particular sector. In this case, consider broadening the impact theme. Failure to obtain buy-in of third-party managers.

Example: Blue Haven Initiative (BHI) is a single-family office based in Cambridge, MA. BHI is managed by Ian Simmons and Liesel Pritzker Simmons, husband and wife, and their team who are passionate about creating social and environmental impact. BHI invests with a philosophy of high standards, aiming to improve social and environmental performance across its portfolio while optimizing financial returns appropriate to each asset class. BHI creates a balanced portfolio by investing in a variety of capital types, including equity, debt and real assets, and investing in a variety of impact themes, including renewable energy, affordable housing and health solutions. BHI sources and manages direct investments across four continents and multiple sectors. The family office is a member of 100% IMPACT Network, a global peer-to-peer network of asset owners who are committed to aligning 100% of their investments for positive social and/or environmental impact.

Public equity and fixed-income investments are often more limited in attributable social or environmental impact than other asset classes (e.g. private equity, venture capital and real assets) yet exposure to public equities increases portfolio liquidity. BHI tries to increase the impact of public equities through screening, shareholder advocacy and proxy voting strategies. Fixed-income investments offer stable income, decrease portfolio volatility and provide a high degree of liquidity. Often overlooked in the impact space, fixed income can offer needed capital for critical public purposes (e.g. municipal bonds). Working closely with their outsourced CIO, an independent investment services firm, BHI seeks to understand and gradually increase the impact of fixed income using a combination of quantitative scoring and a qualitative assessment of how the underlying issuers use the proceeds. The outsourced CIO also helps screen private fund offerings for BHI, evaluating managers for maximum risk-adjusted financial return as well as positive impact.

Appendix B – Resources to Engage in Impact Investing

Further reading

- Guide to Impact investing For Family Offices and High Net Worth Individuals, Julia Balandina Jaquier, 2011[75]
- A Guide to Contemporary Conversations in the North America Social Good Sphere, Catalog
- Investing for Impact: Case Studies Across Asset Classes, Bridges Ventures/The Parthenon Group, 2010
- Solutions for Impact Investors: From Strategy to Implementation, Rockefeller Philanthropy Advisors, 2009
- A Short Guide to Impact Investing, Case Foundation, 2014
- Evolution of an Impact Portfolio: From Implementation to Results, Sonen Capital LLC, 2013
- From Margins to the Mainstream: Assessment of the Impact Investment Sector and Opportunities to Engage Mainstream Investors, World Economic Forum, 2013
- Charting the Course: How Mainstream Investors Can Design Vision and Pragmatic Impact Strategies, World Economic Forum, 2014
- The Green Money Journal (http://www.greenmoneyjournal.com) – a newsletter that provides resources and contacts for environmentally and socially responsible investments
- Global Learning Exchange library (http://gle.iipcollaborative.org/resources/) – a knowledge sharing platform that serves as a depository of research on impact investing and offers educational webinars on various topics
- The Impact Investor: Lessons in Leadership and Strategy for Collaborative Capitalism, Cathy Clark, Jed Emerson, Ben Thornley, 2014
- Priming the Pump: The Case for a Sector Based Approach to Impact Investing, Matt Bannick & Paula Goldman, 2012

Below are sample listings of networks, forums and other resources that offer opportunities for education, knowledge sharing, investment sourcing and co-investing. Many family office conferences started providing impact investing panels and workshops as well.

Networks and membership associations

- **Aspen Network of Development Entrepreneurs (ANDE), US:** Part of the Aspen Institute, ANDE is a global network of organizations that propel entrepreneurship in emerging markets; hosts series of events, trainings and conferences. http://www.aspeninstitute.org/policy-work/aspen-network-development-entrepreneurs
- **CREO**: A network of family offices, private investors and advisors with a focus on cleantech, renewables and environmental opportunities. http://www.creo-network.org
- **ClearlySo, UK:** A global hub for social businesses, social enterprises and social investments; provides a market place for social enterprises to find financing from social investors; offers a searchable deal database. www.clearlyso.com
- **Enable Impact:** A platform created by the joint effort of Enable Impact and The Unreasonable Institute. The online network allows impact investors, social ventures and impact programmes to connect. http://www.enableimpact.com
- **European Impact Investing Luxemburg (EIIL), Luxemburg:** An information exchange platform for various stakeholders in the impact investing space with the goal to contribute to the development of the impact investing sector and promote the sector in Luxembourg. http://www.impact-investing.eu
- **Global Impact Investing Network (GIIN), US:** A non-profit organization dedicated to growing impact investing space by providing opportunities for collaboration and knowledge sharing; builds sector infrastructure and provides services such as Investors' Council (an exclusive group for active large-scale impact investors), Impact Reporting and Investment Standards (IRIS) and ImpactBase (online global directory of impact investment vehicles). http://www.thegiin.org
- **Go Beyond, Europe and US**: A membership network of angel investors that offers access to deal flow; due diligence and monitoring services and educational opportunities through trainings and a series of events. http://www.go-beyond.biz
- **European Venture Philanthropy Association (EVPA), Belgium:** A membership association of organizations interested in venture philanthropy across Europe; organizes conferences and offers research materials/information. www.evpa.com
- **The ImPact.org, US:** A membership organization of investors who pledge to track and share the social impact and financial performance of their investments. http://theimpact.org
- **Investors' Circle, US:** An early-stage impact investing network of angel investors, venture capitalists, foundations and family offices. http://investorscircle.net
- **Mission Investors Exchange**: Features an extensive library of reports, guides, articles, research, case studies, stories from the field, investment policy templates, and conference and webinar archives. Members can view a database of mission investments made, lists of consultants experienced with mission investing, and a library of members' mission investing contract templates they have submitted for other members to use. www.missioninvestors.org
- **Nexus Global Youth Summit:** A global membership of young investors and social entrepreneurs, who come together to discuss, learn, and collaborate on how to improve philanthropy and social impact. http://www.nexusyouthsummit.org
- **Put Your Money Where Your Mouth Is Community (PYMWYMIC), Europe:** A community of active investors' that share knowledge and experience with the goal of funding impactful companies. http://www.pymwymic.com

- **Social Venture Network, US:** A network of business leaders, social entrepreneurs and impact investors; organizes conferences and events; offers information on the social investing space. http://svn.org
- **The South African network for Impact Investing (SAII), South Africa:** Advances the concept, practice and growth of impact investment in South Africa; SAII hosts a responsible and impact investing conference bringing together investors, social purpose businesses and intermediaries. http://www.saiin.co.za
- **Toniic, Global:** Peer-to-peer network of action-oriented institutional and individual investors with members in over 20 countries. http://www.toniic.com
- **TPW West:** Peer-to-peer platform for innovative philanthropists that provides networking and lifelong strategic education including innovative set of skills, tools, investment models, and resources for philanthropic giving and investing. http://www.tpwwest.org
- **US SIF - The Forum for Sustainable and Responsible Investment, US:** Membership association for professionals, firms, institutions and organizations engaged in sustainable, responsible, and impact investment. http://www.ussif.org
- **Young Investors Organization (YIO), Switzerland:** A global network for “next-gen” families; provides opportunities to build business and investment partnerships. https://www.young-investors.com

Forums and conferences

- **Big Path Capital, Five Fund Forum (USA):** A forum that periodically showcases five investment funds across the spectrum of sustainability including clean energy, microfinance, energy efficiency, sustainable agriculture, green consumer products. http://www.watershedcapital.com/events/five-fund-forum
- **Impact Forum by Asia IIX/Shujog (Singapore/Paris)**: A forum that brings together investors, entrepreneurs and intermediaries in social finance. http://www.impactforum.asia
- **Opportunity Collaboration, Cordes Foundation’s initiative:** A five-day convening of world leaders focused on creating sustainable solutions to poverty. http://opportunitycollaboration.net
- **Sankalp Forum, an Intellecap initiative (Global, India-based):** An annual forum that engages governments, corporations, and influential platforms like the G8 and G20, media and civil society to drive a paradigm shift in inclusive development approaches. http://www.sankalpforum.com
- **The Skoll World Forum on Social Entrepreneurship (UK):** An international platform for advancing entrepreneurial approaches and solutions to the world’s most pressing problems; brings together social entrepreneurs and essential partners in a collaborative pursuit of learning, leverage and large-scale social change. http://skollworldforum.org
- **Social Capital Markets (SOCAP) (Global, US-based):** A conference of global innovators, governments, social enterprises, institutions, foundations, and investors dedicated to increasing the flow of capital to social good. http://socap14.socialcapitalmarkets.net
- **The SRI Conference on Sustainable, Responsible, Impact Investing (US):** A conference focused on investment and practice management issues including shareholder advocacy strategies and community impact investment opportunities. http://www.sriconference.com
- **TBLI CONFERENCE:** Global learning and networking event series in financial hubs across Europe, Asia and the US; offers learning opportunities on sustainable investing. http://www.tbligroup.com

Investment opportunities listings

- **ImpactAssets 50:** A composite list of top 50 impact fund managers categorized by asset class, geographic focus and impact focus. http://www.impactassets.org
- **Impact Alpha:** An open data and resources platform that allows to track companies, investors, deals and people in the impact investing space. http://impactalpha.com
- **ImpactBase:** A searchable online database of impact investing funds across asset classes, impact themes, geographic targets, fundraising status, assets under management and other parameters. http://www.impactbase.org
- **Impact in Motion 15:** Selection of experienced private equity and private debt impact asset managers in the DACH region (i.e. Germany, Austria and Switzerland). http://impactinmotion.com/en/thought-leadership
- **Impact Partners:** Managed by Impact Investment Exchange Asia (IIX), the platform connects impact investors with pre-vetted social enterprises in Asia. http://impactpartners.asiaiix.com
- **ImpactSpace:** An open data and resources platform that allows to track data on companies, investors, investments and people in the impact investing space. http://impactspace.org
- **Maximpact:** A funding and collaboration platform that links funders with sustainable profit and non-profit initiatives and projects with a focus on sustainable development, clean technologies and green investment. http://www.maximpact.com
- **Mission Markets (US):** A platform offering a broad repository of information and supporting a range of financial products, including direct private placements, impact funds and structured debt securities. http://www.missionmarkets.com
- **Social Stock Exchange (UK):** A platform designed to connect the general public (not just accredited investors) with publicly listed impact investments. http://socialstockexchange.com
- **Social Venture Connexion (Canada):** An online portal connecting capital-seeking social entrepreneurs with accredited investors via the MaRS Centre for Impact Investing. http://www.svx.ca
- **US SIF:** Listings of separate account managers and mutual funds in sustainable and responsible investing. http://charts.ussif.org

Shareholder engagement services

- **As you Sow:** http://www.asyousow.org
- **Ceres:** http://www.ceres.org
- **Proxy Impact:** http://proxyimpact.com

Impact measurement tools

- **B Analytics:** B Lab's web-based tool which allows users to research companies and funds, access proprietary impact investing market trend reports, utilize tools to collect impact data on companies/funds and benchmark impact against a global database of private companies; it also provides PULSE – a portfolio management tool, administered by Application Experts (App-X) that comes pre-loaded with IRIS metrics, tracks financial, operational, social and environmental metrics, and creates a range of qualitative and quantitative performance management reports. http://b-analytics.net
- **B Impact Assessment:** B Lab's rating system, offers B-Corporation Certification. http://bimpactassessment.net
- **Global Impact Investing Rating System (GIIRS):** A ratings tool and analytics platform that assesses companies and funds on the basis of their social and environmental performance using IRIS definitions, and generates data that feed industry benchmarks. www.giirs.org
- **Global Reporting Initiative (GRI):** A non-profit organization that produces a comprehensive Sustainability Reporting Framework widely used by companies globally to report their economic, environmental and social performance and impacts. www.globalreporting.org
- **HIP Ratings LLC**: A ratings framework applicable across public and private investments that uses data on ESG measures that directly tie to improved financial metrics. http://hipinvestor.com
- **Impact Reporting and Investment Standards (IRIS):** Part of GIIN, IRIS offers taxonomy that governs the way companies, investors and others define their social and environmental performance, incorporates sector-specific best practices and produces benchmark reports. http://iris.thegiin.org
- **Intellecap PRISM (Portfolio Risk, Impact and Sustainability Measurement) (India):** A web-based impact fund performance measurement framework capturing dimensions of impact such as fund manager's contribution, investee firm's output and local investment context. http://prismforimpact.com
- **iPAR (Impact Portfolio Allocation Review):** A proprietary tool developed by CAPROCK Group to analyse impact strategies, track impact source, and report impact outcomes within client portfolios across asset classes and grants. CAPROCK plans to make the framework available publically although the details have not been finalized as of publication date. http://www.thecaprockgroup.com
- **Shujog Assessments:** Provides a framework to monitor, manage and report impact and a third-party verification of social and environmental value creation for social enterprises to enhance transparency and accountability. http://shujog.org/magnify-impact/impact-assessment
- **Social Progress Index:** Rigorous index rating the social performance of more than 50 countries. www.socialprogressimperative.org
- **Vera Solutions:** A Salesforce-based service provider that will set up a data system to track and maintain social impact data. http://www.verasolutions.org

Family office networks and forums

- Americas Family Office Forum: http://www.terrapinn.com/conference/americas-family-office-forum
- Ask the Circle: https://www.askthecircle.com/about-ask-the-circle.html
- Association of Small Foundations: http://www.exponentphilanthropy.org/formerly-asf
- CCC Alliance: http://www.cccalliance.com
- Confluence Philanthropy: http://www.confluencephilanthropy.org
- European Network of Family Offices: http://www.enfo.net
- Family Business Network: http://www.fbn-i.org
- Family Office Association: http://www.familyofficeassociation.com
- Family Office Exchange: https://www.familyoffice.com
- Family Firm Institute: http://www.ffi.org
- Family Office Metrics: http://www.familyofficemetrics.com
- Global Philanthropists Circle: http://www.synergos.org/philanthropistscircle
- Global Philanthropy Forum: http://philanthropyforum.org
- National Center for Philanthropy: http://www.ncgrantmakers.org/?page=NCFP
- Opal Financial Group's European Family Office & Private Wealth Management Forum: http://www.opalgroup.net/conferencehtml/current/european_family_office_private_wealth/european_family_office_private_wealth.php
- Table Club: http://www.thetableclub.com
- Tiger 21: https://tiger21.com
- The Transitions Program offered by Family Business Magazine: http://familybusinessmagazine.com/index.php?/conferences/transitions

Appendix C – Examples of Options across Asset Classes*

Asset Class	Examples
Deposits/Cash	• Community Development Financial Institutions (CDFIs) in the US and UK • Nature Conservancy Note • Calvert Note • State Beneficial Bank (SF) • Charity Bank Deposit
Public Equity	• Generation Investment Management • Trillium Asset Management • Calvert Solution Portfolios • Robesco SAM • Boston Common Asset Management • Neuberger Berman Socially Responsible Strategy • First Affirmative SRI Equity Income • US SIF listings of separate account managers and mutual funds in sustainable and responsible investing (http://charts.ussif.org/)
Public Debt	• TIAA CREF • Breckinridge Capital Advisors offers sustainable bond strategies in customized separate accounts • ImpactAssets note • MicroVest • Sonen Global Fixed Income Fund • Nikko Green World Bank Bond Fund • Access Capital Strategies • Common Capital • Calvert Green Bond • First Affirmative SRI Fixed Income • US SIF listings of separate account managers and mutual funds in sustainable and responsible investing (http://charts.ussif.org/)
Absolute Return/Hybrid	• Triodos Certificates of Shares • Skyline Innovations
Private Equity/Debt/ Venture Capital	• Many impact investments are private equity/debt investments targeting different impact themes, geographies and expected return profiles. Therefore, rather than profile a few examples here, readers are encouraged to examine the GIIN's ImpactBase database, Impact Assets 50 and other resources listed in Appendix B for examples of such private equity/debt investments.
Commingled/Risk Sharing Funds	• International Finance Facility for Immunisation • The New York Acquisition Fund • California FreshWorks Fund • Global Health Investment Fund

* Examples include sustainable, responsible, and impact investing (SRI) strategies as they can enhance impact portfolio construction for family offices.

Endnotes

1 *From the Margins to the Mainstream - Assessment of the Impact Investment Sector and Opportunities to Engage Mainstream Investors*. September, 2013.World Economic Forum. http://www.weforum.org/reports/margins-mainstream-assessment-impact-investment-sector-and-opportunities-engage-mainstream-i.

2 World Economic Forum Report Series: Ideas to Practice, Pilots to Strategy, http://www.weforum.org/content/pages/report-series-ideas-practice-pilots-strategy.

3 *Charting the Course: How Mainstream Investors can Design Visionary and Pragmatic Impact Investing Strategies.* September, 2014. World Economic Forum, http://www.weforum.org/reports/charting-course-how-mainstream-investors-can-design-visionary-and-pragmatic-impact-investing.

4 There are several key definitional issues. First, it is an investment approach and not an asset class; it is a criterion by which investments are made across asset classes. Second, intentionality matters. Third, the outcomes of impact investing, including the financial return and the social and environmental impact, are actively measured. For more discussion on the definition and taxonomy of impact investing, visit http://reports.weforum.org/impact-investment/2-definitional-alignment.

5 According to Perspectives on Progress: The Impact Investor Survey (J.P. Morgan and the Global Impact Investing Network), 124 impact investment funds manage $46 billion in impact investments. Considering there are over 300 impact investing funds, according to ImpactBase, this estimate is understated.

6 According to the 2012 Global Sustainable Investment Review's estimate (Global Sustainable Investment Alliance), global assets under management in 2012 constituted $62.3 trillion; Boston Global Consulting's Global Asset Management 2014 report estimates $68.7 trillion in global assets under management in 2013.

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11 The goal of this primer is to offer a starting point. Those interested in more in-depth studies should refer to "Guide to Impact Investing for Family Offices and High Net Worth Individuals" by Julia Balandina Jaquier and "Evolution of an Impact Portfolio: From Implementation to Results" by Sonen Capital and the KL Felicitas Foundation.

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75 A follow-up edition of the guide will be published by J. Balandina in 2015.

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