Financing Social Good: Impact Investing in Canada

Old Problems, New Solutions

A revolution is underway in the way that we resolve social problems. Citizens no longer look to government for all the answers, and indeed, even if government had all the answers, they do not have all the money. Charities are forever challenged to maintain a level of funding that enables them to solve long-term, complex social and environmental issues. More and more, we see the private sector stepping up to deliver social benefit along with their traditional goods and services. A rising wave of social entrepreneurs is starting to make a meaningful difference to people's lives. They are designing their businesses with the explicit purpose of driving social and environmental change. And impact investing is arming the revolution with the financial means to succeed.

Impact investing is an approach through which investors allocate capital to investments where they expect to both receive a financial return and have a positive societal impact. Impact investors are distinguished by their intent to drive a specific, measurable social or environmental benefit. Figure 1 illustrates where impact investing is situated across a continuum of investment approaches.

Figure 1

			IMPACT INVESTMENT		
Traditional	Responsible Investing (RI)	Socially Responsible Investing (SRI)	Thematic	Impact-first	Venture Philantropy
Competitive Returns					
	ESG Risk Management				
		High Impact Solutions			
Investments made with the motive of attaining a financial return with limited or no focus on Environmental, Social or Governance (ESG) factors.	Investing in a manner that screens out certain sectors (e.g., tobacco, weapons) as a component of financial risk management.	An approach that involves comprehensive negative and positive screening of ESG risks as a part of the investment analysis process.	An approach that focuses on one or more issue areas where social or environmental needs have created a commercial growth opportunity for market-rate returns.	Investments made in issue areas where achieving measurable social or environmental impact may require some financial trade-off.	Social enterprise funding in a variety of forms, with a range of return possibilities. Investor involvement/ support is common.

Source: Adapted from Bridges Venture Research (2012). *Sustainable & Impact Investment — How we define the market*. Retrieved from www.bridgesventures.com/links-research.

The Marketplace for Impact Investing

Like traditional finance, the impact investing marketplace includes those who supply capital, those who demand capital, and intermediaries and enablers.

Impact investors supply the capital that funds projects, programs and businesses that deliver solutions to social and environmental problems. Impact investors can include governments, individuals, foundations, banks and pension funds. Their financial return objectives can range from simply seeking the eventual return of the investment principal, to expecting competitive market-rate returns.

What's the difference between **Impact Investing** and **Socially Responsible Investing**?

Both socially responsible investing (SRI) and impact investing involve a consideration of environmental and social issues along with financial returns. However, SRI typically involves placing capital into companies or funds that have been screened against Environmental, Social and Governance (ESG) factors. The companies may be among the best in their sector at managing environmental or social issues, but they do not usually exist for the purpose of making a particular social or environmental impact. Impact Investing, on the other hand, is a type of investing where investors seek to place capital in companies or other organizations that offer market-based solutions to particular social or environmental challenges that are in an area of interest of the investor. In practice, SRIs are usually made in publicly traded companies, while impact investments are more often made in private corporations, non-profit and other organizations.

The demand side of the market includes companies in myriad sectors, non-profit organizations, and charities, cooperatives and projects that need capital to open, operate or expand. Some sectors, such as water, energy, Aboriginal business and agriculture, have offered strong opportunities for creative solutions and favourable conditions for investors. Other sectors, such as affordable housing, financial services, health and education, have been slower to develop in Canada, yet present promising future opportunities given their track records in other jurisdictions.

The flow of capital from investors to investees is supported by a number of intermediaries and enablers. These groups, which include incubators and start-up accelerators, play a critical role in building the capacity of entrepreneurs, developing financial products, brokering financial transactions and matching capital.

A Highly Fragmented Product Landscape

Impact investment products are offered across a wide spectrum of asset classes with a range of risk and return profiles, including cash and cash equivalents, private and public debt, private equity, venture capital, real estate and Social Impact Bonds.

Social Impact Bonds gaining traction

Social Impact Bonds (SIBs), also referred to as "social innovation financing" and "pay for success" are gaining attention as a risk-free way for governments to fund social programs. In a SIB agreement, the government enters a contract with an intermediary who is responsible for raising capital from investors and managing service providers who will tackle the social problem. If (and only if) the program is successful in achieving the pre-determined social outcome, the government will repay investors from the savings realized through the program. The first SIB in Canada was recently issued in Saskatchewan, and a number of other provinces are exploring opportunities with this innovative structure.

At present, the majority of impact products are designed for institutional and private investors. A number of challenges are making it costly and complex to structure impact products for retail investors, and consequently, there are relatively few retail products available.

The Challenge of Measuring Impact

Demonstrating real and measurable social impact is critical to the long-term success and credibility of impact investing. Both investors and investee organizations face a number of challenges when it comes to impact measurement. Measurement metrics and frameworks are still in their infancy, making many of them time-consuming, complex and costly to implement. Some measurement frameworks and methodologies currently used to report on outputs, outcomes and impacts are Environment, Social and Governance (ESG) metrics, Impact Reporting and Investment Standards (IRIS), Social Return on Investment (SROI) and Global Impact Investing Rating System (GIIRS).

Stakeholder Collaboration: The Key to Success

Leaders within the private, academic and philanthropic sectors are working hard to catalyze the growth of impact investing. Public policy is essential to regulate and grow the impact investing marketplace. Whether it's increasing the accessibility of capital available, redirecting existing capital to more impactful opportunities or enabling and supporting social enterprises, it's essential for government to be sitting at the table. Hard work, leadership and collaboration from each sector and region across Canada is required if impact investing is going to reach the scale and depth of its potential.