LINE OF SIGHT

IMPACT INVESTING:
A GUIDE FOR PHILANTHROPISTS AND SOCIAL INVESTORS

December 2013

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INTRODUCTION

In recent years, impact investing has emerged as a growing sector and economy and is considered by many experts in the fields of philanthropy and socially responsible investing as one of the most promising approaches to leveraging private resources to create social benefits. Its recent gain in popularity may be a result of investor recognition that philanthropy and for-profit investment don't need to live in separate quarters. "In the past, investors wanted to make as much as possible to maximize the amount that could be given away," says Marguerite Griffin, Northern Trust's national director of philanthropic services. "More people are starting to think that making as much money as possible isn't as important as aligning investments with their mission and values."

First coined in 2007 by the Rockefeller Foundation, impact investing is essentially an umbrella term used to describe investments that create positive social impact beyond financial returns, or an investment strategy that intentionally aligns the investments held by an organization – or in its portfolio – with the mission of that organization. In other words, impact investors seek to create social benefits, such as alleviating poverty and improving the environment, in addition to financial profits.

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SOCIALLY RESPONSIBLE INVESTING OR IMPACT INVESTING?

Socially responsible investing (SRI) is an investment strategy that considers environmental, social and corporate governance criteria (ESG) to generate competitive and long-term financial returns while having a positive societal impact. SRI seeks to build portfolios of assets that exclude companies that offer products or engage in practices that are deemed to be irresponsible by the investor or contrary to the investors' personal goals and values or the mission(s) of their charitable organizations. In contrast, impact investing focuses on inclusion: including companies and investments that are aligned with the organization's mission, rather than screening out companies and investments that are not.

PRIVATE FOUNDATIONS AND IMPACT INVESTING

Proponents of impact investing maintain that private foundations are uniquely positioned to employ impact strategies because these entities have access to pools of investment capital that are earmarked for social purposes by law. Indeed, along with the socially responsible investment and corporate social responsibility movements of the 1980s and 1990s, private foundations have played, and will continue to play, a vitally important role in building the impact investing market. In 2009, the Monitor Institute estimated that the impact investment industry could grow from $50 billion in assets, the estimate at that time, to $500 billion by the year 2020 as more foundations, family offices, high-net-worth individuals and for-profit organizations make impact investments.

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SOCIAL ENTERPRISES AND HYBRID ORGANIZATIONS

The field of impact investing has been significantly fueled by new and innovative business models and legal structures referred to, respectively, as "social enterprises" and "hybrid organizations," that are enabling for-profit companies, nonprofit organizations, social entrepreneurs and social investors to achieve financial returns while prioritizing social benefit objectives. Social entrepreneurs have recognized the limitations of the "not-for-profit" legal form and are increasingly deciding to organize and conduct business through these new structures.

Social Enterprises

A social enterprise, also known as an "impact enterprise" or "impact business," is essentially an organization or venture that achieves its primary social or environmental mission using various business models and methods. An example of a social enterprise would be a business that seeks to advance green energy, where one division of the business functions as a nonprofit organization and is engaged in energy research, and the other division functions as a for-profit energy consulting business. Both divisions share the same purpose and are controlled by the same managing board of directors.

Hybrid Organizations

Also known as "hybrid charities" or "hybrid social ventures," hybrid organizations may be generally organized like traditional limited liability companies or for-profit companies, and yet have the characteristics of both for-profit businesses and nonprofit organizations. They have grown in popularity based on the needs of nonprofit organizations and for-profit businesses to raise additional revenues from sources that would otherwise be unavailable to these entities given their legal framework. For example, nonprofit organizations that are seeking to expand globally or improve the quality of their products and services may need to reach out to capital markets for additional sources of revenue. Similarly, for-profit companies that are interested in promoting socially responsible practices may seek to tap the resources of individuals and private foundations.

ENGAGING THE MILLENIAL GENERATION

As the field of impact investing continues to evolve, as new and innovative impact strategies continue to be headline-grabbing news, and as social benefit programs that are supported by impact investments begin to show results, the extent to which economic, environmental and social challenges are addressed will likely influence how stakeholders – philanthropists, governmental entities, nonprofit and for-profit organizations, private investors and the capital investment markets – remain engaged.

The Millennial generation of wealth inheritors, in particular, expect to "do well" and "do good."

Some would say that the future of philanthropy and social investing rests squarely on the shoulders of the next generation of leaders and social investors who seek to tackle the world's most challenging social problems. The Millennial generation of wealth inheritors (born from 1981-1995), in particular, expect to "do well" and "do good." They believe that funding a social enterprise rather than making a charitable contribution may be a more effective way to achieve social benefits. They are showing great interest in incorporating socially responsible investments in their personal investment portfolios and customizing the portfolios of their families' charitable foundations to be environmentally and socially impactful.

THE FUTURE OF PHILANTHROPY?

Philanthropy historically has been an essential catalyst and the primary tool by which individuals and institutions have addressed economic, environmental and social challenges. Arguably, impact investing is one of the most innovative solutions to address these challenges in the 21st century and beyond. As private, public and philanthropic assets continue to flow into impact strategies and socially responsible investments, and as the number of social enterprises and hybrid organizations continues to increase, there will be even more opportunities for philanthropists and large and modest investors to "do well" while "doing good."

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