Wayne Silby

Impact Investing: Frontier Stories

Many people think I started out as a do-gooder. Not exactly. When I graduated from Wharton, my dreams were focused on independence, including the financial kind. Right out of law school, with my Wharton buddy John Guffey, I started one of the first money funds in the country. Our financial engineering strategies created the money fund that was not only the highest yielding but also the safest. The first Calvert fund, started in 1975, used guaranteed floating Small Business Administration [SBA] loans. Money rolled in. Within a few years, still in our 20s, we were managing Washington's largest mutual fund. Then I went to a conference that changed my life.

This conference, on a post-hippie commune in New Hampshire, was on the topic of Right Livelihood. Right Livelihood is a Tibetan Buddhist concept, part of the eightfold path for leading one's life. It's about integrating one's work with one's values, in contrast to the old Western model of making money whatever way we can and then donating. So, here I am at the conference, thinking my life's work is getting another half percent financial return for our investors over the next guy. Hmmmmm!?? It got me thinking. From these ruminations was born Calvert Social Investment Fund: the first socially responsible investing (SRI) fund to comprehensively integrate my generation's aspirations with the investment process. The guru from the conference center, Marc Sarkady, served as the first chair of our advisory council, and that council's vision attracted amazing people.

As the first public fund to do social investing, we turned a few heads and got some strange looks: promising as we looked, were we still on some drugs from the '60s? Even the Securities and Exchange Commission asked questions about a fund that would set aside 1 percent of its assets at below-market rates for the purpose of furthering social justice. They also asked what the word "holistic" meant in our proposed prospectus. We got used to being seen as a little weird.

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But the relevant tenet of our fund model was that we should also set aside some monies for the seedling companies of the future: our Special Equities program. These are private companies, not yet big or publicly available, that have products or services that, in the larger, more holistic context, meet real human needs and have the potential for a double bottom line return.

WHAT IS IMPACT INVESTING?

I don't know any best definition of "impact investing." It's a mosaic: many tiny efforts to do the right thing with private investment, including an extra effort that our commercial markets lack. For example, about eight years ago we invested in the China Environment Fund in Beijing. Only six investors showed up for this small fund and its cause, and we were the only U.S. investor. People again thought I was a bit weird—thinking that the Chinese would ever care about their environment. Now the fund is in the hundreds of millions and is the "go to" clean-tech fund in China, with commercial investors knocking on its door. I have no doubt that this was an impact investment when we made our first investment—and when it gave us outsized returns. But now that it is commercially successful and contains new funds, I wonder if it is still an impact investment.

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The motivations for impact investing are many. The Wall Street problem of recent years—how to make money with money, especially other people's money, without regard for the real human consequences—has caused our whole society to rethink the status accorded Wall Street bankers and financial engineers. We who are the knowledge workers benefiting from the free market system have lurking concerns about our chosen system and its growing divide between rich and poor. We can donate to nonprofits, but impact investing gives us the chance to use some of our investment dollars to make a world that offers more equal opportunities. Micro-finance is an example of creating dignity among the underserved, by lending based on character and eschewing handouts. A few years ago I was speaking to the high net worth crowd. Now most of those in my audiences have a goal of financial stability or better. But how much do we need? How much is enough? At what point do we become fiduciaries for society as a whole, given the extra wealth we have? I envision a day when the impact advisor turns to the rich client who just asked if he can get a high return on an investment: “You need a double-digit return? Did you just become poor or something?”

The Grameen Growth Guarantee Fund is a good example of how impact investing works. Grameen Foundation USA involves a number of wealthy people who guaranteed a $35 million credit facility at Citibank. The backers did not need to put up any money. Grameen arranged loans between local banks and local micro-finance institutions, using a Citibank letter of credit based on those guarantees. The outcome? Dozens of new relationships were created among local finance institutions working together on a near commercial basis to get about $200 million in loans to the poor. Grameen backers took some, but not all, of the risk in the financing between the local groups, as the lenders are required to have some skin in the game. Five years later, the program for the first guarantee “fund” is nearing its end and has had no losses, or “calls” on the backers. So, it’s a great example of enabling terrific social impact by simply lending access to one’s balance sheet.

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Another pull for me is the fun of working with talented and high-minded people to see how investment work can fit into promoting the greater good. Young people are drawn to these broad and interesting conversations about real total impact. At Harvard Business School, the most popular club is not VC, PE, or hedge fund, but the social enterprise club. Many traditional venture capital investments are just about “faster cheaper better,” or how winners can take from losers. Impact investing allows you to think about real needs, about market gaps, and about what just might be truly transformational portfolio investments.

In my experience, it is too easy to be limited by jumping to business models and ways to monetize the value proposition. Some of my best projects came from concentrating first on what was needed and worrying about the financial model later. Calvert Social Investment Fund was started primarily as the chairman’s pet project as a model for the right thing to do. Now assets in Calvert social funds are in the many billions. Five years ago I met a Chinese student who was working on corporate social responsibility (CSR) in China for his PhD. My first impulse was to just give him some money so he could disseminate his work via a website, etc. But then I thought about ongoing financing needs, and I suggested we start a consulting company in Beijing, drawing on another weird idea: that the Chinese would care about CSR. Syntao now has 20 people, has been quite profitable, and has had an impact with its sustainability reporting. One of our clients is the largest cell phone company in the world, with 550 million users. In a meeting with their head of corporate strategy, we discussed how CSR principles could help them find underserved markets and also strengthen user relations. And last month, I was in a meeting with the chairman of one of the largest financial newspapers in China, which is interested in how their 1,000 reporting companies and Syntao could work together. These are all successful impact investments that I might not have made if my mind was initially cluttered with money-making concerns rather than real long-term needs.

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FINANCIAL RETURNS

Of course we would all like to save the world and make a lot of money doing it. But I think leading with that thought does not serve our nascent movement. I have great respect for one impact investor in Atlanta who expects that his portfolio will actually lose some money, given that his investments aim at high risk and high social impact but modest return. Most traditional venture funds make their money with their one or two home runs. Impact investments are often second- or third-base hits when they do work: consider the trade-offs involved in going after markets that involve the poor, or experimental ventures, or those with no lock on intellectual property. All those factors can limit the potential return. Fortunately, the impact marketplace provides a wide spectrum of risk and double bottom line returns. And often the social objective helps with returns. At Calvert Foundation, our affordable mortgage loan portfolio performed much better during the crisis compared to mortgages from banks that didn't focus on their clients' real needs.

The biggest determinant of return may actually be the skill of your investment manager in selecting and supporting the companies. Venture investing is a hard business and you learn from your mistakes. My first fund, Calvert Social Venture Partners, was started in the late 1980s. We were really taken with the social visions of the companies we invested in. Big mistake! Better to fall in love with the talents of the entrepreneurs and management in making those visions a reality. We also did not have an industry focus. Now we have more humility about what we know, and generally go into companies that have knowledgeable co-investors.

We will, however, support first-time fund managers and their funds, as we believe we understand that business, as long as we are familiar with their market segment. For example, we were the first institutional investor to commit to LeapFrog, which targets the new micro-insurance market. Our commitment got them rolling, opened other institutional doors, as it has in several other instances, and resulted in a $150 million raise. We believe this is an important way that Calvert Special Equities can help the impact marketplace, as institutional investors are rarely very entrepreneurial and are therefore leery about supporting first-time funds, which could involve a career risk.

ON METRICS

Measuring social metrics has become fashionable in recent years as this industry goes into a growth stage and the consultants arrive. I find this a challenging area to pin down and have enjoyed reading Jonathan Lewis's blog on the topic. We once invested in a mortgage on a job retraining center for convicts. The recidivism rate fell, and we tried to calculate that financial return to society, on top of the 7 percent return we received. We weren't able to be very precise, but we knew we were doing the right thing. Calvert's research department helps with the overall public policy trends that are sometimes relevant to a particular investment. We had one heated discussion over a health-care technology company that was really more involved in working the old system to get higher reimbursement rates than in finding solutions that were perhaps less elegant, but much cheaper and still reasonably effective. To me, it's critically important to ask the questions, but we are still a bit reluctant to make investments only where the social returns lend themselves to standard quantification.

We do consider the social impact against the expected financial return. As an extreme example, we invested in a Latin American company that is promoting student loans that allow people to follow their passions rather than having to choose a job that lets them pay back the loan the fastest. The business model calculates the payback as a percentage of the graduate's actual future income. So people who are likely to go into teaching will likely pay back less, and those who will go into business or a profession may pay back more. This is a highly risky first-time model, but we decided to make a small investment, as this could change the education funding game for those not enfranchised in the traditional system.

THE FUTURE OF IMPACT INVESTING

The last few years have seen an explosion of interest in impact investing. The SOCAP conferences have attracted outsized crowds. We used to call it "social venture capital" and "community investments." The Rockefeller Foundation has provided a lot of infrastructure support, especially by promoting the "impact" name, which has broadened the tent. Just this year, the White House has backed conferences on the impact economy. SBA and OPIC are two government agencies with an impact agenda recently formulated with funds to support the industry. And conferences are now being held in Hong Kong and many other parts of the world. But some structural issues surround the process of moving monies into this area in a way that is commensurate with the buzz.

First, under ERISA, the pension governance act, the Bush-era interpretation deems that all investments must be in the sole financial interest of the beneficiaries. Some movement is afoot to change this act so that retirement funds have the option of putting up to 2 percent of their money into impact investments, where the concept of beneficiary interest is expanded to include the quality of the society into which the beneficiaries are to retire. This seems like a no-brainer but . . .

Another big pot of money is the sovereign wealth funds (SWFs). In an article in *Pensions and Investments Asia,* I asked, “Sovereign Wealth Funds: Do They Get It?” How socially useful is it for the hedge funds to play zero-sum games, or for buyout funds to add leverage, both of which are typical investments of SWFs? It seems that creating an investible world, with some monies set aside to ensure long-term sustainability and social stability, would slightly improve the overall risk-adjusted returns of SWFs and reduce their volatility. (And I will nominate for the Nobel Prize in Economics the person who can prove this.) I had a discussion with the treasurer of the World Bank that focused on a big study about SWFs investing in food security in Africa. The proposal aimed to make a modest return that respected the social needs of local people, with oversight from the bank. Then, I was with some people from the China Sovereign Wealth Fund and asked them about policy to ensure food security. At least one of them said it might be better to invest at 6 percent and be able to feed their people than to invest in a buyout fund at 10 percent that could risk the stability of the Chinese government due to increasing food prices.

One additional trend is attracting the public into this field. Why should only accredited investors have the opportunity to express their values through their investment dollars? Calvert Foundation has succeeded in raising money from the public to invest in a portfolio of MFIs, CDFIs, and other local loan funds that are putting financial resources into the community. Members of the public can participate in a relatively safe way with $1,000. But the trend in investing is toward being more granular: more targeted, less diversified, going for more specific projects that resonate with the individual investor. A more targeted approach makes it possible to unlock more funds; this is a goal of ImpactAssets, with its innovative donor-advised fund. Some firms are working on this challenge, part of which relates to the SEC and blue-sky state laws. But I envision a day when people can talk, on their resumes and their Facebook pages, about their favorite impact investments as an expression of who they are. While it’s important that money get to the right projects, it’s also important that people get to be a part of this new cultural meme.