

# inflection. points

VOL I N° 9 • 1 JUNE 2011

## Impact Investing 2.0: Time for a new approach

by Dr Matthew Kiernan  
[mjk@inflectionpointcm.com](mailto:mjk@inflectionpointcm.com)

“Impact Investing” is generating an enormous amount of “buzz” these days – even if it is talked about much more than it is practised. It has become particularly popular among foundations, endowments, and high net worth individual investors. While the precise meaning of the term is still being defined and debated, in essence, impact investing is a style which explicitly pursues social and environmental objectives as well as purely financial ones. In many cases, investors are willing to sacrifice some of the latter to achieve the former.

Typically, impact investing occurs in the emerging markets, in private transactions, and at a small scale – to date the average investment has been in the USD 1 million range. Typical projects might include the purchase and distribution of cleaner-burner cooking stoves or solar-powered lamps to rural villages in Africa, Asia, or Latin America. All very good stuff, but...

I recently attended a session on impact investing at a Clinton Global Initiative meeting in New York City. The two most common laments from impact investing devotees were the enormous difficulty of generating positive impact at the necessary scale, and the related fear that there simply weren't enough investable projects to absorb the level of capital potentially interested in investing in them.

We at IPCM would like to respectfully propose a complementary (not replacement) strategy which could resolve both of these serious problems. We call it “Impact Investing 2.0”, and we have been practising it in one way or another for well over a decade.

Simply put, Version 2.0 focuses instead on large and mid-sized companies in the public markets. Our thesis is quite straightforward: we seek to leverage the enormous power of the global capital markets to drive significant improvement in the social and environment performance – i.e. impacts – of major companies. We attempt to do so by being explicit that those impacts are consciously being used as partial proxies for the overall management quality and, ultimately, the financial performance of public companies being considered for investment. Over and above good old-fashioned investment skills (including, of course, robust sustainability analysis), the key to the success of Impact Investing 2.0 is two-fold:

- Investors must communicate their logic and thought processes widely and clearly to both companies and other stakeholders. Companies must know what is motivating and animating their investors.
- The impacts must be measured – and communicated to clients and others.

> *continued overleaf*

## The BOP alternative

Approximately four billion people in this world live on \$2 or less per day. This group at the bottom of the socio-economic pyramid has been termed the “base of the pyramid” (or BOP), beginning in 2002 with the seminal article “The Fortune at the Bottom of the Pyramid” by two U.S.-based academics, Stuart Hart and C.K. Prahalad.

The basic premise of the concept (“BOP Version 1.0”), was that, contrary to both intuition and popular belief, poor people do have considerable purchasing power, and are indeed responsible borrowers. Subsequent evidence has borne out this latter point: repayment rates for the celebrated Grameen Bank in Bangladesh are around 99%, a figure that bankers at the likes of JPMorgan and Citigroup can only envy.

BOP 1.0 was focused on poor qua consumers, and argued that, for companies nimble, flexible and committed enough, the BOP could be an attractive and growing customer market, and a useful hedge against the growing probability of saturation and stagnation in developed markets. After an initial rush of enthusiasm, however, critics began complaining that BOP activity was simply a new strain of economic imperialism: merely “selling to the poor”, with most benefits flowing to the vendors, not their ultra-low income customers. While perhaps overstated, there is at least a grain of truth in this allegation. Thus was born “BOP 2.0”, which has taken the concept to another level altogether.

Under BOP 2.0, a more egalitarian model is emerging, with the poor as co-creators and co-owners of new micro-enterprises providing goods and services uniquely adapted to their environments. BOP 2.0 views the poor not merely as consumers, but as an enormous resource of untapped human capital. Under this approach, communities get much more than simply new products and services: they generate jobs, entrepreneurial skills, new income, economic and social development, and, perhaps most important, dignity. Sounds idyllic, doesn't it?

The only problem is that BOP 2.0 is devilishly difficult to pull off successfully in practice, and there are few real-world examples where it has been truly effective. The challenges of such game-changing initiatives are prodigious.

As an excruciatingly demanding test of management quality, the ability to conceive and execute effective strategies for tapping the potential of the BOP is hard to beat. Virtually every aspect of the mindsets and the business models which have been successful in developed and affluent developing markets need to be reinvented. In short, show us a company which can dramatically out-perform its sector peers on the BOP challenge, and we'll show you an exceptionally well-managed company, period.

The fact that most investors completely ignore this factor simply adds to the information advantage of those who do not.

> Admittedly, this is a daunting challenge, but it simply must be met if Version 2.0 is to achieve the necessary credibility, scale, and impact. The lack of this measurement and reporting function has seriously compromised the veracity of the (unsubstantiated) claims made by many of our current commercial fund providers.

Fortunately, it is actually easier to do this sort of analysis on a large universe of public companies than on the bewildering diversity of difficult-to-compare, apples-and-oranges projects pursued under Version 1.0.

If this approach could be adopted by a large enough critical mass of investors (say, a significant portion of the USD 25 trillion behind the UN Principles for Responsible Investment), and if this could be backed up by market-beating returns, corporate boards and executives will be unequivocally put on notice that their social and environmental performance is being carefully scrutinized. Leaders will be rewarded with more plentiful and affordable investment capital, while laggards are denied it. This, in theory, creates a powerful incentive for substantial improvements, and a virtuous circle.

Given that with Impact Investing 2.0, we are by definition talking about big multinational companies, the potential for positive impact is huge – and infinitely larger than is the case for Version 1.0.

Think, for example, of the positive environmental impact already achieved by WalMart's celebrated campaign to drive environmental and energy efficiency improvements throughout its own operations and those of its 100,000 suppliers. Most experts expect that WalMart will have removed over 20 million metric tons of greenhouse gases from its supply chain by 2015 – the equivalent of taking nearly 4 million cars off the road for an entire year. And we won't have to take WalMart's word about this impact: the respected U.S. NGO Environmental Defence will be monitoring its progress and reporting publicly.

Now imagine an entire series of funds consciously designed to produce social and environmental benefits – at scale – and combine them with superior financial performance. Imagine further that those positive impacts are actually measured, and compared against benchmarks or business-as-usual outcomes. Finally, imagine that even 5% of the investment capital currently supporting the UN PRI were to invest in such funds. That would put over one trillion dollars to work in the service of social and environmental improvement – and superior financial returns. Now that, folks, is impact investing!

**Show us a company which can dramatically out-perform its sector peers on the BOP challenge, and we'll show you an exceptionally well-managed company, period.**



inflection.  
point  
CAPITAL MANAGEMENT

Inflection Point Capital Management  
100 King Street West, Suite 5700  
Toronto, ON M5X 1C7, Canada  
+1 416 399 2861  
info@inflectionpointcm.com  
[www.inflectionpointcm.com](http://www.inflectionpointcm.com)

#### DISCLAIMER

The information contained herein has been prepared solely for informational purposes and is not an offer to buy or sell or a solicitation of an offer to buy or sell any financial product, security or to participate in any trading strategy. Content contained herein may not be reproduced or disseminated in whole or part without the prior written consent of Inflection Point Capital Management (IPCM). While every effort has been made to ensure the accuracy of information contained in this newsletter we cannot provide guarantees. IPCM disclaim liability for any loss or damage which may arise as a consequence of any person relying on information contained herein. Before relying on any information in this newsletter please independently verify its accuracy, currency and completeness.

#### ABOUT US

**Inflection Point Capital Management** is a new, sustainability-driven asset management boutique. A research-driven organization, IPCM builds on the knowledge base and networks of its predecessor company, Innovest Strategic Value Advisors. Innovest was ranked by the Thomson Extel survey of institutional investors as the #1 research firm in the world in the sustainability space. IPCM has offices in London, New York, Toronto, and Melbourne.