



Achieving impact for impact investing

A road map for developed countries

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The report is the result of collaborations between the Financing Agency For Social Entrepreneurship (FASE), Ashoka Germany, and McKinsey & Company. The underlying analysis builds on interviews with 50 leading experts, including senior professionals from foundations, the public sector, asset management units, financial intermediaries, social businesses, specialized consulting firms, and many more. The authors thank these experts for their invaluable contributions.

Executive summary

Investing for profit and the philanthropic use of financial resources are commonly perceived as irreconcilable alternatives. Nevertheless, recent publications and debates have seen a rise in awareness of impact investing, which is defined by yielding both a social and a financial return. A current example of impact investing would be profit-oriented investments in additional integration programs for asylum seekers in Germany, which could yield a high social benefit. Building on the example of Germany, the following report cross-examines this hybrid investment class and its relevance and performance in developed markets. An assessment of the status quo of impact investing and potential development paths is intended to shed some light on opportunities and restrictions for Germany and similar markets.

Developed countries continue to face well-known social challenges while new ones emerge. For Germany, consistent levels of long-term unemployment even in times of so-called high employment and a lack of societal mobility are examples of well-known challenges. More recently, unprecedented numbers of asylum seekers have entered Germany, creating the need for a short-term infrastructural response as well as a long-term labor market integration strategy. In addition to the individual hardship, the societal costs of these social challenges are immense. For Germany, a potential investment need of nearly EUR 50 billion in 2025 has been identified to address only a few selected social challenges.¹

On the other side, capital markets exhibit favorable conditions for new investment strategies, partly due to the global financial crisis of 2008. Abundant capital needs to be matched with suitable investment targets. Lower financial returns are acceptable, as long as investments exhibit low market correlation and low interest rate correlation. Among comparable low-yield and low-risk assets, the social-impact dimension may gain importance in investment decisions. Thus, the provision of capital to businesses with the intent to generate positive social impact and financial returns has seen a recent rise in interest.

Despite these encouraging trends, impact investing is still a niche market in most developed countries, with limited evidence of its financial performance. The impact investing market is growing fast across the world, but is far from comparable to other asset classes. In Germany, only around EUR 70 million are currently under management in this space, and not all of these assets are yet allocated to social purposes or organizations.²

Few specialized investors, a lack of investment-ready entrepreneurs, saturated larger NGOs, and constraints on infrastructure limit impact investing's development. Institutional investors and retail banking customers cannot invest, as larger investment opportunities and structured investment products are missing. High net worth individuals (HNWI), foundations, and some government agencies make up the greater part of the impact investing market. Investment-ready social entrepreneurs with an understanding of the investment landscape,

1 EUR 50 billion reflect the need for additional investments to address four exemplary social challenges: the increase in lifestyle diseases due to an increased life expectancy, the scarcity of affordable housing, long-term unemployment, and the shortage of care for the elderly.

2 Does not include individual deals by foundations, family offices, and high net worth individuals (HNWI).

a risk-taking mindset, and sufficient expected returns to offset the investment transaction costs are few. The impact investing market infrastructure is not fully developed, as current intermediaries are relatively small. Further, investment incentives and a supporting regulatory frame are missing.

The impact investing market can be developed if actions are taken to establish a functioning ecosystem. To develop the German impact investing market, a few concerted actions need to take place. Intermediaries need to offer products of a sufficient size, e.g., by bundling impact investments with social and responsible investments (SRI), to bridge the lack of larger impact investment targets. Grants, junior tranches, or guarantees by philanthropic investors should enable investments by traditional investor types. For this to happen, syndication is needed. A supporting regulatory framework and subsidies, e.g., up-front tax deductions and write-offs for losses, should be developed to foster the young market. Pay-for-success schemes can create further incentives for new social innovation and investment. All of the identified measures need to be coordinated as a joint action in order to best ensure stable market development.



01

Social need for impact investment and capital market conditions that support it

Like most developed economies of the Western world, Germany faces a series of persistent and emerging social challenges that place an increasing burden on society. Projected public expenditure for social services in Germany is estimated to increase from around 28 percent of GDP in 2014 to around 33 percent of GDP in 2060.³ One known driver of the increase is the rise in health expenditures, which is triggered by an aging society and lifestyle diseases. But more recent challenges, like the shrinking workforce, widening social inequalities, and a large increase in asylum seekers are also contributing to this trend.

Modeling four large social challenges for the German social system shows that the emerging costs are immense. Adding up the investment need to fully tackle the lack of affordable housing, the increase in lifestyle diseases, the shortage of care for the elderly, and long-term unemployment reveals a projected shortage of nearly EUR 50 billion by 2025 in these four areas alone – which equals about a sixth of the 2015 federal budget.⁴

³ Sachverständigenrat (Government Council of Experts)

⁴ EUR 299,100 million (www.bundeshaushalt-info.de)

Investments of EUR 29 billion are needed to provide affordable housing. Rents have risen significantly in metropolitan areas, with increases ranging from 10 to 30 percent between 2005 and 2015.⁵ The trend is projected to continue. At the same time, between 2002 and 2010, social housing availability decreased by 800,000 apartments,⁶ since the government switched to transfer payments to support the living expenses of those that are struggling to meet their rental payments.

“The need for capital to solve social challenges is massive.”

Head of large public-sector research institute

EUR 15 billion are needed to prevent the increase of lifestyle diseases. Lifestyle and aging-related diseases are projected to significantly increase until 2025, resulting in increasing costs for society. An ongoing prevention program of EUR 15 billion by 2025 could potentially reduce costs induced by these diseases by five times its size.⁷

EUR 3.5 billion are needed for senior living communities to tackle the shortage of care for the elderly. By 2025, an additional 840,000 elderly will be in need of care, requiring an additional 375,000 geriatric nurses.⁸ Training these nurses in traditional programs would incur a cost of EUR 3.5 billion.⁹ Further, experts know that it is especially hard to find people willing to learn nursing, making it difficult to attract the numbers required.

EUR 1.9 billion are needed to integrate long-term unemployed people into the labor market. Fifty percent of the long-term unemployed are low-skilled. They will be even less employable in the future, since technological advancements reduce the need for low-skilled workers. In numbers, the demand for all low-skilled workers in enterprises is projected to decrease by 41 percent by 2030.¹⁰ However, only 10 percent of all low-skilled, long-term unemployed are in training programs to improve their skills.¹¹

Based on the analysis of these four areas, it is clear that there is an urgency to consider the financing of innovative solutions for these social issues. An analysis of other societal challenges would likely reveal additional impact investment opportunities. If innovative solutions are financed through impact investing early, they become a larger social sector market.

5 Cologne Institute for Economic Research

6 Eduard Pestel Institute

7 Estimate based on lifestyle disease rates from the Fritz Beske Institut für Gesundheits-System-Forschung Kiel and on cost-benefit analysis of health prevention programs conducted by the Burda Foundation.

8 Estimate based on the “Shortage of Care” study by the Bertelsmann Foundation (“Themenreport Pflege 2030”)

9 Estimate based on costs for two- to three-year vocational training for geriatric nurses covered by the Federal Employment Agency as part of the “Ausbildungs- und Qualifizierungsoffensive Altenpflege” (initiative for geriatric care training and qualification)

10 Estimate provided by the Institute for Employment Research – the Research Institute of the Federal Employment Agency

11 Annual average in 2013 as reported by the Federal Employment Agency

Impact investing is, by popular definition, only feasible when an investment in an organization allows for amortization and a yield in addition to a social return.¹² Interviews with a range of investors have provided some insight into the financial performance of the still young impact investment class. Theoretically, returns may span the full range of the financial return spectrum with their underlying defining risk and competitiveness. Practically, the financial upside even of scaled social businesses is often capped, since generating large profits from social activities is mostly seen as ethically questionable. This locates feasible return rates in the lower but financially viable range of the spectrum. Overall, the financial market has recently developed a set of conditions that are favorable for impact investment and can make it a viable and competitive option for investors.

Favorable conditions in post-financial-crisis capital markets. In the aftermath of the financial crisis, investors shifted to lower-risk strategies and focused on absolute gains. Assets exhibiting little correlation with capital markets have seen a rising demand. This, combined with limited growth in many economies, led to lower and even negative real yields for some risk-free assets, e.g., German federal securities. As interest rates are expected to rise again, investors want to limit their exposure to equities.¹³ Given this environment, impact investing could be an interesting alternative if decent financial returns are offered in addition to a socially beneficial impact.

The market is growing fast across the world. The Global Impact Investing Network (GIIN) estimates that the impact investing market has grown at a rate of 37 percent per year since 2010. Eurosif (European SRI membership organization) measured the growth of impact investments committed by professional private investors in Europe from 2011 (the first year they measured impact investing) at 52.3 percent per annum, reaching a total of EUR 20 billion in 2013.¹⁴

Financial performance may be competitive, but evidence is limited. A meta study on the performance of SRI indicates that the application of environmental, social, or governance (ESG) criteria has no negative effect on risk-return ratios, partially due to the fact that they can become an internal business driver in the long run.¹⁵ Nevertheless, traditional investment theory suggests that ESG restrictions may have negative effects on performance, as they restrict the choice of investment opportunities. Both indications apply to impact investing

12 In a narrow understanding, only investing in innovative social solutions is seen as impact investing, whereas a wider understanding includes all investments in organizations tackling social challenges with a measured social impact at the core of their business activities.

13 McKinsey estimates that around 16 percent of the US profit pool is at risk for every 100 basis point interest rate uptick.

14 European SRI Study 2014, Eurosif

15 "The Impact of a Corporate Culture of Sustainability on Corporate Behavior and Performance" (Eccles, Ioannou, Serafeim, 2011). Internal business drivers include state decisions when moving out of the fossil fuel industry or allocating contracts in the waste industry to ESG-conforming enterprises; consumer decisions in certain retail industries; and correlation of regulatory and reputational risks to non-ESG-conforming conduct.

as well, and there is evidence for positive as well as negative effects of impact investing on financial returns. In the developing world, evidence indicates that impact investment funds can outperform benchmarking funds.¹⁶ As for the developed world, evidence is limited. Some examples from the UK show that impact investments can outperform traditional ones, e.g., Bridges Ventures.¹⁷

“If impact investing does not adhere to the rules of the capital market, it will not get the funds of the capital market.”

Head of Responsible Investment of a large German bank

Investments may have a positive diversifying effect. Performance of investment targets is often barely correlated with larger indices. Correlation analysis shows that microfinance – a subcategory of impact investing – is weakly negatively correlated with large equity and bond indices.¹⁸ In developed countries with extensive welfare systems, social businesses often rely on state financing, disassociating their performance from financial market developments.

Financial returns may be capped. The business case for social businesses focuses on the provision of a social or public good not yet provided for by traditional businesses. This often limits the space for high returns. In addition, generating large profits from social activities is generally seen as ethically questionable, especially in Germany. Thus, it is still unclear whether social activities have the potential to yield large profits and, thus, significant returns.

¹⁶ GIIN and Cambridge Associates

¹⁷ Bridges Ventures has managed to deliver IRR of up to 20 percent (Bridges Ventures homepage).

¹⁸ It is positively correlated to money markets as microfinance investment loans are typically short term with maturities of two years or less, whose interest rates follow money market rates (Global Social Finance – Perspectives on Progress, 2010, 2011, 2013, 2015; Eccles, Ioannou, Serafeim, “The Impact of a Corporate Culture of Sustainability on Corporate Behavior and Performance,” 2011; McKinsey analysis)



02

German niche market and obstacles to development

Despite the positive social-impact potential and favorable market conditions, impact investing is still a niche market in many developed countries. And in fact, there may be a significant risk of even this niche market failing, as it does not meet the current expectations of investors. In Germany, only EUR 70 million are currently under management in this space, and not all of these assets are allocated to social purposes or organizations.¹⁹ A number of requirements are yet to be put in place to allow for the development of a well-functioning ecosystem of investors, intermediaries, target organizations, and enablers (e.g., regulation and subsidies). The impact investment ecosystem is dependent on the quasi-synchronous development of all dimensions. For example, larger investors will not be able to invest without an investment target of a sufficient size. Some existing hurdles to impact investing are outlined below.

¹⁹ Does not include individual deals by foundations, family offices, and HNWI

Not all types of investors can enter the market. Small, mostly philanthropic funds are the gateways to impact investing capital at this point. Among the investors are HNWI, foundations, and government agencies. Additional requirements would need to be fulfilled to attract larger investor groups.

Institutional investors are the largest investor group with around EUR 6.4 trillion of assets under management (AuM) in 2014.²⁰ They need to follow strict regulatory paradigms and are bound by their fiduciary mandate when allocating their funds. To win institutional investors – or any investor following their highly regulated standards – impact investing needs large structured and liquid investment opportunities, with large ticket sizes. The ecosystem is some steps away from being able to offer such ticket sizes or to conform to the demanded reporting standards.

Retail banking customers, as nonaccredited investors, are similarly bound by regulation. Tax and fiscal rules are designed to create incentives for them to remain in mainstream investments (e.g., need to sign special forms). Retail customers are dependent on financial intermediaries to structure investible products for them.

Foundations can draw from three types of capital. The first type is grant money which cannot easily be invested, as it needs to be spent without a return and may not cross-finance profitable business models. The second type, the capital stock, needs to adhere to a sustainable investment strategy. Due to recent court rulings, foundations are cautious about investing in risky asset classes. If a decided and signed investment strategy is expected to be sustainable, the capital stock may be invested “with impact.” The third type, reserve funds (“Leistungserhaltungsrücklage”), describes the capital stock accumulated to ensure business continuity in times of inflation and substantial capital loss. For some foundations, this capital stock has a considerable size. It can very likely be invested in impact investing assets and could make a considerable contribution to the establishment of the impact investing market.

Pipeline of investible businesses is not developed. Many actors are already tackling social challenges with innovative ideas and many more are positioned to do so, making them the potential targets of impact investors.

“It is a challenge to find appropriate investment targets.”

Head of specialized impact investing fund

Most innovative social solutions require investment tickets of around EUR 100,000 to 500,000, but most investors are only able to match ticket sizes beyond EUR 500,000. Especially in developed countries, it is hard to find expanding, investment-ready social entrepreneurs

²⁰ Total financial assets of institutions in 2014, excluding intangible assets and short-term assets, estimation by McKinsey Global Growth Cube

with this kind of investment need and an understanding of the investment landscape, a risk-taking mindset, and sufficient expected returns to offset the transaction costs for making and monitoring the deal. Early-stage social entrepreneurs face challenges similar to those of scaling entrepreneurs, but they lack a proven business model and require investments of below EUR 50,000, which makes it hard to construct a financially viable investment case for them.

“The market is too small, too diversified which hinders major change to happen.”

Head of large philanthropic foundation

Established social-sector organizations, such as Caritas, Diakonie, Deutsches Rotes Kreuz, Johanniter, and Malteser Hilfsdienst, are not in the focus of impact investors since they focus on social innovation. But even if these larger organizations were counted among the impact investible, they often try to reduce their exposure to external capital to reduce the amount of profit generated from their social work. Investment projects like larger construction sites may draw from internal assets, specialized investors (e.g., lotteries, churches, nongovernmental organizations), government programs (e.g., “Aufbau Ost”²¹), and specialized banks (e.g., the Bank für Sozialwirtschaft²²). In addition, they can easily raise money from traditional capital markets due to a high credit worthiness and, in many cases, government-guaranteed streams of income.²³ But even they lack the external financing of nonproven innovative business ideas with risk capital.

Established private-sector organizations raise capital via traditional channels. Social impact is not a priority in most of their business decisions and as such neither measured nor reported. But if their core business contributes to the solution of a social challenge (e.g., car sharing, data analysis of influenza patterns), organizations could measure this impact and attract further investment. So far, social innovation based on corporate know-how is not fully leveraged by impact investing.

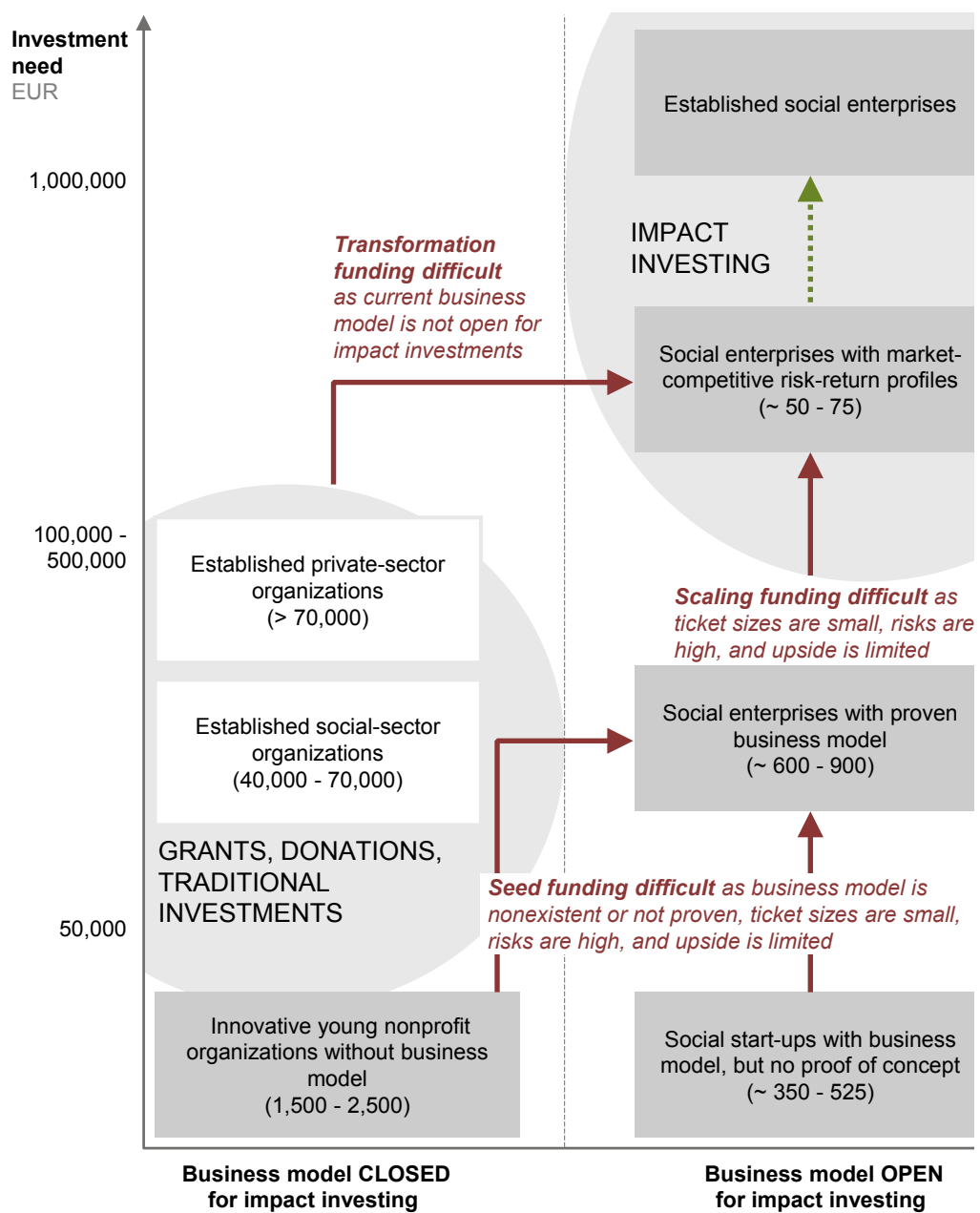
In short, seed and scaling funding for social entrepreneurs is inhibited by high transaction costs, and financing innovative concepts within the social or private sector via impact investing is extremely difficult (Exhibit 1).

21 “Aufbau Ost” was a government program to stir the economies of former GDR states.

22 “Bank for Social Business”

23 Representatives of these larger established organizations report investors from various backgrounds asking for investment opportunities on a weekly basis.

The investment pipeline is blocked at several points, limiting the number of social entrepreneurs to around 50 to 75 organizations



Current intermediaries are limited in their size. Pioneer financial intermediaries have started paving the way for impact investing. Players like BonVenture and Ananda, which are closed funds, and FASE, which facilitates single deals, successfully match funds with investees. Nevertheless, they would not be able to absorb large amounts of capital with their current resources. Scaling and additional specialized players would be needed to manage a larger market once it evolves.

Subsidies and a supporting regulatory frame are missing. Development subsidies targeting social entrepreneurs are limited. There are no guarantees for investments or up-front tax deductions. There is no adequate legal framework for social ventures enabling the investment of grants and impact investments at the same time. Authorization of impact investing vehicles for nonaccredited and institutional investors is not yet in place. Finally, regulatory transparency for foundations on how they may invest in impact investing funds is missing.

Giving and investing are seen as conflicting spheres. In 2014, individual giving amounted to approximately EUR 5 billion (excluding corporate donations, donations larger than EUR 2,500), but it was limited to charitable organizations. The blending of the social and the private world is new and uncommon, especially for Germans. Nevertheless, if one accounts for potential negative consequences, e.g., shifting incentives for social business leaders, individual giving could help smaller revenue-based models bridge an often nonprofitable development phase.

“It is difficult to finance business development as access to traditional capital is restricted and grants for social for-profit organizations are difficult to get due to regulations and public perception.”

Social entrepreneur



03

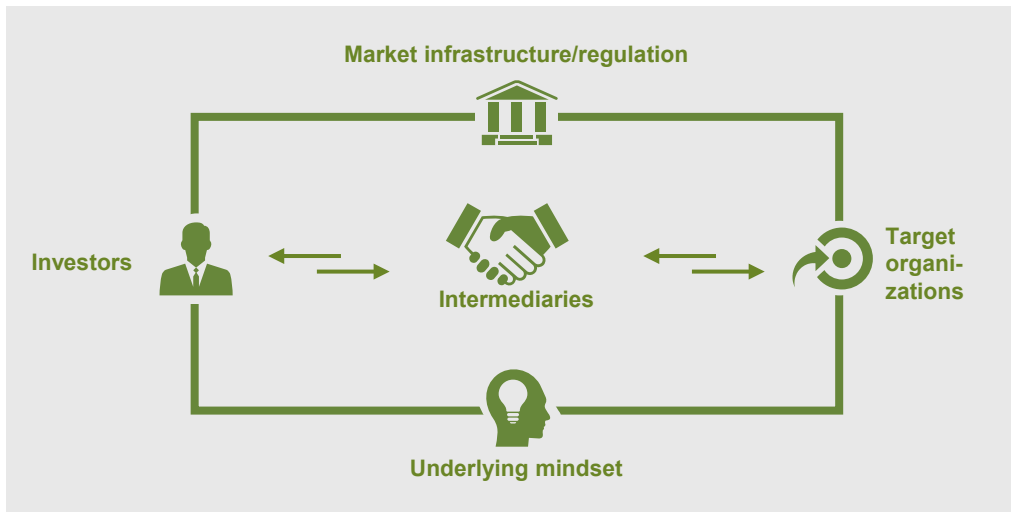
Road map to an established impact investing ecosystem in Germany

To fully leverage the social-impact potential and open up the EUR 50 billion investment opportunity, a functioning ecosystem needs to be established (Exhibit 2). Diverse investor groups need to be able to invest in various actors via financial products invented by large and knowledgeable financial intermediaries. Subsidies and policies need to be tailored to support the ecosystem. An understanding of the risks and benefits of impact investing needs to be built among the wider public. Targeted transformative actions headed by impact investing champions need to happen in successive phases until a functioning ecosystem is fully established.²⁴

²⁴ The appendix outlines all proposed transformative actions.

In an established market, organizations working on social challenges would build on a supporting ecosystem

In its target state, a well-functioning ecosystem ...



... would build on the fulfillment of all key requirements



- Institutional investors (more than 50% of the market)
- Retail customers
- Other investors (e.g., family offices, foundations)



- Social enterprises scale and grow and offer market-competitive risk-return assets
- Many new ideas are being developed (seed phase)



- Major German banks
- Specialized intermediaries
- Products tradable and available to retail customers



- Incentives for social investments
- Standardized investing vehicles regulated by BaFin*
- Corporate form combining charitable and for-profit model
- Standardized impact measurement framework
- Online platform connecting all actors



- All actors accept concept of combining social and financial return

* Bundesanstalt für Finanzdienstleistungsaufsicht (Federal Financial Supervisory Authority)

Develop financial products blending different investment needs. Hybrid investments, or blended finance, work by combining the preference profiles of different investor types in direct or indirect investments in order to create products viable for all investor types. Given the high risk associated with many impact investing assets at this point, three mechanisms can make investment of regular capital more viable.

“Impact investing needs to include hybrid financing to enable development.”

Leading social enterprise advisor

- **Grants can complement investments.** The provision of grants by a recognized foundation that is asking for co-investments may help build trust and at the same time improve the business case of the investee.

Example: Civic Builders used a USD 300,000 grant by the US Department of Education to provide a credit enhancement for USD 1.4 million equity investments targeted at building a Democracy Prep Charter School.

- **First-loss capital/junior tranche can reduce risks.** Foundations or philanthropists provide first-loss capital to reduce the level of risk for other investors providing a senior tranche.

Example: Equity for Tanzania received USD 1.2 million in junior tranches from the Government of the Netherlands. Other investors invested a senior tranche of USD 3.6 million.

- **Guarantees can reduce risks.** Public authorities or foundations provide guarantees to reduce the downside risks.

Example: European Commission's Programme for Employment and Social Innovation (EaSI) Guarantee Financial Instrument provides an 80 percent loss guarantee for the first 30 percent of lost capital.

Four target groups have been identified for blended finance:

- **Seed social start-ups (EUR 50,000 ticket size).** Focus on enabling the development of a revenue-based initial business model for innovative small nonprofit organizations and social enterprise start-ups. The idea is to allow innovative small nonprofit organizations not focusing on business development and social start-ups to reach proof-of-concept stage to increase the number of organizations that will require larger investment volumes to scale their activities in two to four years.

Example: Original Unverpackt was funded by crowdfunding in 2014 with a funding need of EUR 24,000.

- **Scaling start-up social enterprises (EUR 100,000 to 500,000 ticket size).** Focus on expanding social start-up enterprises with an existing proof of concept. The idea is to bridge the financing gap between the initial minor funding and larger ticket sizes to enable the scaling of activities. It will increase the number of organizations that will require larger investment volume to further expand in two to four years.

Example: KfW and BonVenture, with the help of FASE, invested in the national rollout of discovering hands®, a diagnostically superior examination method for breast cancer, by training blind people as skilled diagnosticians.

- **Established social-sector social innovators (EUR 100,000 to 500,000 ticket size).** Focus on social innovation by established large social-sector organizations. The idea is to enable established social-sector organizations (spin-offs and intrapreneurs) to leverage their know-how in innovative and daring ways that are currently not covered by traditional funding.

Example: Startnext and ES GEHT! funded Caritas's social business development for the renovation of the *magdas* HOTEL run by refugees in Vienna.

- **Corporate social innovators (EUR 100,000 to 500,000 ticket size).** Focus on social innovation by private-sector organizations. The idea is to enable private-sector organizations (spin-offs and intrapreneurs) that have proprietary access to knowledge and superior R&D skills, e.g., in big data analytics, to leverage the social impact that they could have but which is currently not a priority under their current business rationale.

Example: Real estate investors, Deutscher Städtetag, and German government institutions could fund housing companies, like Deutsche Annington, to develop innovative solutions for refugee accommodations, e.g., by following an integrative approach to real estate provision.

Structure impact investing products for wealth management. Financial intermediaries can cover a large share of the funding value chain if they structure products for institutional investors, HNWI, and other accredited investors as well as retail customers. This would enable them to profit from an interesting market opportunity. As demand and the market are growing fast, they can stand out from their competitors, attract future employees, and rebuild the reputation of the banking sector. First strategy ideas include:

- **Bundle impact investing with SRI.** In bundling the more established asset class SRI with impact investing, investible products can quickly be set up. This enables a successive and dynamic shift towards impact investing as the market develops. Social and ecological banks currently have around EUR 9 billion in AuM in such instruments. If their growth pattern continues, they will see 12-percent growth per annum until 2025.

Example: The Triodos Bank has led the way with its Sustainable Equity Fund, which holds 50 percent of revenues in impact-creating activities by “sustainable pioneers” and 50 percent in ESG best-in-class enterprises.

- **Target existing private-sector organizations with impact at their core.** Identifying the social impact of existing private-sector organizations and developing practical measurement schemes can help increase the investible market size and direct capital to where it helps solve social challenges. A first screening of feasible social-impact sectors identifies a potential of up to EUR 50 billion by 2025 in sectors such as environment and energy, healthcare, unemployment, and affordable housing.

Pilot pay-for-success scheme in a large Land (county) and ensure subsidies. As pressure on budgets increases, counties are in a good position to increase their roles in social innovation. A county has three main ways to foster social innovation:

- **Full pay-for-success schemes.** Service providers receive payment only if certain predefined social impact is fulfilled, e.g., formerly absentee students graduate. Income is guaranteed for social enterprises if they are successful, and impact investors prefinance the activities and take on the risk.

“The German social system is pretty much covering many social challenges, but should focus more on performance.”

CEO of an impact investing incubator

- **Partial pay-for-success schemes.** Service providers receive fixed amounts for services plus a bonus for achieving medium- to long-term social-impact objectives, e.g., employees in employment 12 months after job training. Successful activities are rewarded and can be scaled, and impact investors can finance the activities.

“Public subsidy programs should be introduced to enhance the development of a self-sustaining, non-subsidized market.”

CEO of a sustainable bank

- **New impact premiums.** As service providers do not receive payment for currently unlisted and non-predefined services, a budget exists for solutions to social services that are currently not covered if the impact is measurable. Social entrepreneurs are incentivized to tackle social challenges that are currently not being addressed, e.g., discrimination in social networks, and impact investors can prefinance the activities.
- **Subsidies to support social innovation.** As outlined above, governments can engage in direct subsidies via guarantees, junior tranches, or co-investments to incentivize investments by traditional investors. Indirect subsidies may include up-front tax reductions, write-offs for losses, and lower tax rates for profits generated via impact investing.

“Investors and investees need to speak the same language and balance between each other’s objectives.”

Social entrepreneur

Set up crowd-investing platform. Social entrepreneurship enablers can set up a crowd-investing platform to quickly open the impact investing market to the wider public. The seamless selection of targets, bundling of funds, a functioning legal framework for investments, and the processing of payments related to the organization of the amortization could help raise awareness, allow for small investment sizes, and enable social entrepreneurs to receive funding from places other than traditional sources. In addition, success cases could help to build acceptance for the combination of social and financial returns.

Closing remarks

The described measures need to be implemented in a short time frame to best address the outlined social challenges and respective investment requirements. The proposed measures need to be linked in the form of joint action to ensure a stable market development process. Thus, collaboration and alignment of stakeholders is required, for example within an overarching multistakeholder initiative.

This report focused on the German impact investing market as an example for impact investing in the developed world. Many characteristics and requirements may be similar in other developed markets but should be reviewed to take market specifics into account.

Appendix

In order to achieve an established market, stakeholders need to take concerted actions

2016				
Investors	Finance first		Test and discuss ideas	HNWI/family offices invest in hybrid fund
	Impact first	Small-scale investors invest	Develop guides for stakeholder	Pilot hybrid vehicles Refine hybrid vehicles
Financial intermediaries		First specialized vehicles and deal by deal in place	Define impact investing in bankers working group (BaFin)	Widen scope with social banks and private sector
		Pilot co-investment fund	Set up investor circles	Banks define overall impact investment strategy
Investment targets		Very few social entrepreneurs use impact investing		Impact investing seed funding becomes popular
Enabler	Infrastructure	Plan road map for impact investing	Standardize measurement	
		Ensure investment readiness with trainings	Set up crowd-investing platform	
	Government	Set up dedicated cross-ministry team	Pilot pay-for-success scheme	Pilot subsidy scheme on micro-level

Source: Expert interviews; literature review; McKinsey analysis

Prioritized actions

2018	2020				2022
Joint competence center for family offices		Institutional investors start to invest		Retail customers invest	
	Replicate funds	Set up social-sector innovation funds		Set up corporate innovation funds	
Structure products for wealth management		Structure product for institutional investors			
			Structure product for retail customers		
	Impact investing scaling funding becomes popular		First established social organization uses impact investing	First corporate uses impact investing for social innovation	
	Promote established social-sector impact investing	Promote institutional impact investing	Promote retail impact investing	Develop concept for corporate social innovation	
	Implement legal form for social corporates	Open up a scaled pay-for-success scheme		Introduce tax incentive	Refine subsidy system
					Define rule to allocate 5% of portfolio to impact investing

Development of the ecosystem needs to take interdependencies into account

Key contacts

Dr. Markus Freiburg
Founder and CEO, FASE
Prinzregentenplatz 10
81675 München
www.fa-se.de

Felix Oldenburg
European Director, Ashoka
Prinzregentenplatz 10
81675 München
www.germany.ashoka.org

Dr. Matthias Daub
Partner, McKinsey & Company
Budapester Straße 46
10787 Berlin
www.mckinsey.com

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