

# Impact Investing: Financial, Social, Environmental

Clifford David 23 October 2012

Angel and impact investing are becoming more visible as important catalysts within the world of start-up capital, and Philadelphia, through companies such as Investors' Circle Philadelphia, is leading the way in implementing mechanisms for successful impact investing that responds to local needs. While there is no exact formula to predict a successful impact investment strategy, applying rigorous due diligence, along with intuition as to the capability of emerging leaders, can help guide decision-making.

## Angel and Impact Investing

Angel investing blends the heart and mind into the investment decision-making process. The practice of angel investing has been around for many years. The basic concept is loaning money to small start-up businesses that have reached a certain operational need for capital. It is designed to be the next step in growing a business after what is often called bootstrap finance—that is, using savings, credit cards and friends and family to launch the business.

Angel investors are often the first professional lenders

who provide financial support to a growing business. These investors come in before a bank or lending institution would want to take a chance on a start-up. From angel investors, companies that continue to grow will look for larger institutions or funds that will take them to the next level. Each level of investment requires more complicated and sophisticated analysis as the financial instruments are made available to a larger audience of financiers who have greater fiduciary responsibility and require more sophisticated documentation and due diligence than the average angel investor.

The angel investor can be defined as an individual or institution that focuses on early stage start-up companies. The first investments from these groups are usually small, typically ranging from as little as \$25,000 to \$250,000. Once a company gets beyond a quarter of a million dollars, a new level of investors is sought. Angel investors often like to be involved in the early stage of a start-up business and eventually hand it off to investors with more financial resources. This involvement can range from just investing money to being an advisor to being an active member of the company's board of directors.

In Philadelphia there are a number of angel investment groups (Robin Hood, Delaware Crossing Investor Group, etc.) that meet to evaluate start-up businesses. The groups are made up of qualified investors as defined by the IRS and investment funds that are looking to finance start-up companies that the investors believe have a

strong chance to succeed.

Within the angel investment community there is growing interest in what's called impact or triple bottom line investing. This is the idea that money can be invested where it can have a positive impact in multiple forms. First, like any good traditional investment, it will produce a return on capital: invest and you will get your money back with an additional return. But there are two additional elements that commonly shape impact investment. First, many impact investment strategies support businesses that produce a positive impact on the environment (think solar panels, new techniques for recycling, shared automobiles, etc.) These are the businesses that bring positive results to the environment while generating a return for the investor. Second, impact investing typically possesses a social element, such that the people who work for the company, the vendors, the suppliers and related businesses are treated in a healthy, sustainable manner—good, safe working conditions, fair pay, medical benefits, nondiscrimination and in general a place people want to come to work.

## **Investors' Circle**

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Locally, Investors' Circle Philadelphia ("IC Philadelphia") is currently making its mark as an impact investor. IC Philadelphia is a chapter of Investors' Circle (IC), a

national nonprofit organization with investors dedicated to investing in impact businesses. IC, the parent organization, was founded over 20 years ago to foster impact investing, and has attracted hundreds of small businesses from around the world. The group started with offices in Boston and San Francisco. Conferences are held on the east and west coast on an annual basis. More than 20 companies present to approximately 150 angel investors and, out of the presenters, 3 to 10 may receive funding. To date, 234 companies have received over \$150 million in angel investment funding.

The idea for regional chapters of IC arose during these national meetings, among members who had a desire to focus on more local business opportunities. Since IC members came from all over the United States, it seemed logical that groups within smaller geographic regions could gather more easily and have greater access to and involvement with local companies. This local strategy would allow IC members to better participate in all of the logistics of a start-up company, including funding, monitoring, mentoring and overall support of the businesses. At times, investors even become members of the board of directors of the company to assist in the growth of the company and monitor the use of the investors' funds.

In the summer of 2009, four members of IC who live in the Philadelphia region met to discuss a local chapter. The founders of IC Philadelphia contacted the national chapter

and agreed that a local chapter in an area where there is significant interest from IC members and a strong community of early-stage businesses would be a valuable mechanism for expanding the impact, visibility and mission of the organization.

The Philadelphia group met several times to determine how best to operate and coordinate with the national office. Recruiting new members, defining roles, responsibilities and operating arrangements with the national office were all part of the process. After two years, IC Philadelphia was fully established and began investing money in local businesses that met its impact investing strategy. The group consists of 18 members and is growing. We have evaluated over 30 businesses, invested in 5 and are in the due diligence process for several more. The mission of IC Philadelphia is, "To provide capital and strategic counsel to early stage companies in the Philadelphia region focused on solving meaningful social or environmental challenges."

IC Philadelphia is the first of what we hope will be many local impact investment groups across the country. There have been meetings in Boston, New York City, San Francisco, Durham, NC and other locations discussing how to bring together investors at a local level that can have an impact on supporting small businesses that can bring environmental and social benefits to a community while building a strong local economy.

# Investing in Start-up Impact Companies

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The idea of bringing significant amounts of private capital into the impact investment sector of business has been growing steadily with organizations such as B Lab, GIIRS and Slow Money each playing a role in educating the public about the added value and benefits that impact investing can bring to a strong and healthy environment and economy.

There is no science to determining which companies will succeed and which will fail. With that said, there is a great deal of research and thought that has been given to evaluating what makes a good angel investment in an impact company. Investors' Circle has developed a 33-page document/questionnaire to use as a guideline for ensuring that the critical questions are asked and answered before an investment decision is made.

The document begins with, "The primary goal of the due diligence investigation is to discover and analyze all of the material information necessary to enable the relevant parties to understand fully the business of the target company and to identify and satisfactorily address the material areas of concern." Starting from this broad statement we have broken the inquiry process into five major categories: Management, Business Model and

Strategy, Financial Assessment, Operational Assessment and Research and Development. Under each of these categories there are hundreds of detailed questions that cover everything from, "Is the CEO a leader, a manager or both?" to "Have you considered recent changes in the tax law that affect the company?" The due diligence process is considered fairly standard for any analysis before making an investment in a company.

The unique aspect of impact investing is that it goes beyond the financial elements and adds additional evaluation criteria focusing on environmental and social impacts of the business. This type of analysis is not new but the systems and software of the process are developing rapidly. Two leaders in impact analysis process are B-Labs, a nonprofit founded in Philadelphia that has developed a score card for businesses to evaluate how well they are doing in the impact business arena. A second and more sophisticated system that looks at global funds to evaluate their impact investment strategy is GIIRS, another Philadelphia-born impact evolution system.

## **The Impact Investor**

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There is no clear mechanism, tool, formula or crystal ball to identify with certainty the company with the right entrepreneurial leader, a great idea to improve our

environment and bring social justice to all involved, and the capability to yield a positive financial return for their investors. Some (a lot) of an impact investor's decision is based on intuition, a sense of the leader of the business, what the future may hold for the new idea and the belief that this is a good idea with a great leader that needs to be nurtured. Impact investing is about doing good and doing well, it is about using the capitalist system in a way that will produce a better quality of life for society and protect our precious ecological systems that support earth's life forms.

**Cliff David has been involved in conservation and sustainable development for over 25 years. He currently serves as the President and CEO of Conservation Economics. Cliff has worked for government, nonprofit, and for-profit organizations. His expertise is in creating economic solutions and opportunities that blend financial returns with environmental improvements. He is President of Investors' Circle-Philadelphia, an angel investors group that seeks to invest in companies that produce triple bottom line results: financial, environmental and social returns.**