Making Impact Investible

Preface to the Portuguese Edition

March 2014

Impact Economy
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Preface

Portugal has a number of unique assets including its privileged access to the 494 million consumers in the European Union and the 220 million consumers in the Portuguese-speaking countries around the world. Coming out of its deepest recession in more than forty years, with ten quarters of economic contraction, the country is at an important juncture.

Thus I am especially pleased to see "Making Impact Investible" translated to Portuguese now, in connection with the launch of the country's pioneering IES Social Investment Lab and the dedicated kickoff event hosted by the Gulbenkian Foundation on February 27, 2014, where I am grateful to have been invited to present the present report's key findings.

To restore its long-term competitiveness and achieve inclusive growth, Portugal still faces significant adjustment ahead. But make no mistake: this is also a unique opportunity to modernize the country and its economy, and render Portugal future proof for the coming decades. Investment capital will play an important role in achieving this. And one can draw inspiration from the country's awe-inspiring accomplishments during the past three decades. Shortly after the country entered the European Community in 1986, I was fortunate to spend two formative years living in Lisbon. At the time, there was no continuous motorway between Lisbon and Porto. An amazing transformation has taken place since; including life expectancy, which has increased by ten years, and infrastructure, which has made a significant leap forward, in many cases to world class.

Coinciding with Portugal's current adjustment process, we are now witnessing the early days of the next transformation of the global economy. At its core is a very powerful idea: the simultaneous and intentional creation of economic and social or environmental value, in and by all sectors of economy and society, and powered by innovative ways to access and allocate capital, based on incentives to achieve financial and extra-financial performance simultaneously to benefit shareholders and stakeholders.

This opens the path to use capital much more efficiently to fund solutions to social and environmental challenges. After Portugal's recent period of austerity, further reducing the level of public good provision on education and health—to name but two examples—risks taking social cohesion beyond the breaking point. And to create the urgently needed new jobs that were lost in the crisis, the country needs to build new sources of comparative advantage other than cost. This requires both money and innovation. Mainstreaming impact investing, the topic of this report, has the potential to help unlock and finance the innovations that are now needed to drive social progress and inclusive growth at a scale that matters.

Based on the progress made around the world in investing for social impact and financial returns alike over the past decade, we can now design financial instruments with embedded incentives to drive micro-level improvements that touch lives and boost competitiveness such as lowering the cost of grade repetition—which currently imposes an additional burden of more than ten percent on Portugal's total primary and secondary education expenditure—; or—to stay in the field of education—, financial instruments that will help bring the cost down of boosting Portugal's level of educational achievement from currently 32 percent of high school diplomas in the 25-64 years age group up to the OECD average of 74 percent. Youth unemployment shot up twenty percentage points in the crisis. We will need fresh solutions to ensure opportunity for all. In the mainstream of the economy, we can similarly envision financial instruments to fund the upgrading and reactivation of the country's key industries such as Portugal's fashion industry, which lost one third of its jobs in the past six years. Key in all cases is to link financial incentives to the continuous improvement of social outcomes, and the intelligent combination of different sources of capital, rewarding risk-taking appropriately.

As the reader will see, impact investing can add up to big change and drive both the modernization of public good provision and private sector value creation on an unprecedented scale. But to deliver on capital formation, business opportunities and new jobs, social inclusion and effective operational implementation in Portugal, impact needs to be first made investable. Necessary conditions for a functioning impact capital market are the following:

- A sound impact investment ecosystem composed of quality investors, investees and intermediaries;
- A generally competitive social sector; and
- A supportive national policy agenda.

The cheapest and fastest way to build such a capital market is collaborative, systemic action. The report covers the lessons of a number of examples of market building around the world, including the pioneering lessons from the UK experience. From work in a number of countries around the world on adjustment, impact and investment issues over the past fifteen years, I have learned that when we benefit from the lessons from elsewhere, we must nevertheless work very hard to adapt instruments and pathways so that they fully respond to the specific characteristics, in this case the Portuguese economy, society and capital market.

With the caliber of talent assembled already at the IES Social Investment Lab, led by its brilliant scientific coordinator Prof. Filipe Santos and its coordinator Antonio Miguel, as well as backed by the prestigious Gulbenkian Foundation and the UK leader in social impact bonds Social Finance, as well as a number of other partners, we are right to set very high expectations for the IES Social Investment Lab.

The brief is to play a catalytic role in helping to build Portugal's impact investment market. But let us not forget that the Lab's leaders have had the courage to take on a task that is as important for the country as it is challenging, and thus deserve our fullest support.

In 1988, I moved to Europe's West Coast. And I think this is how we should think about Portugal. Not in terms of aiming for California's public deficits of course, but asking how we can unlock an analogous ability to innovate. 500 years ago, the Portuguese navigators traveled uncharted territory, established new trading routes with incredible personal courage, using the best science available at the time. They brought back many new ideas and goods that were transformational for Portugal, Europe and the world. The pathways of change have become more abstract since the days of the navigators' ships. But impact investing has all the power to be similarly transformative to build a more prosperous and inclusive Portugal, Europe and global community in the twenty-first century, if we are rigorous, daring, and collaborative.

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Lisbon, February 27, 2014

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Martin, Maximilian
Making Impact Investible
Impact Economy Working Papers, Vol.4,
Portuguese Edition, 1st Edition
Geneva 2014

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