We Need to Talk About Impact…

Impact Investment Provocations Series

Patient Capital: Patience is of Value not just a Virtue

Many impact investment advocates around the world set out laudable goals for addressing complex, often intractable, social and environmental problems, ranging from entrenched disadvantage, to affordable and social housing, to biodiversity and wildlife conservation. However, while these are crucial goals for the field to contribute to, there is relatively little evidence that impact investment, at least in Australia and New Zealand, has had significant impact in relation to any of these spaces.

This provocation tackles one of the key mindset and practice barriers that often underpins a mismatch of intention and impact in the investment field when it comes to using capital for addressing complex issues; patience – the time and perseverance it takes to truly understand, blend and structure appropriate forms of capital, and then implement responses that address complex issues and create long-term impacts.

Patience has a place in investment

There are certainly precedents within the investment field that point to both the possibilities and the challenges of long-term, patient approaches.

- **Private equity** has built financial mechanisms around long-term, risky and illiquid investments.
- **Layered approaches** in public-private partnerships and joint ventures have ensured private and public investments can help deliver on long-term infrastructure projects.
- **Community shares** illustrate the power of community members coming together to fund or purchase locally important services and assets, often creating long-term impacts for regional community access.

And if we look at philanthropy and its links to impact investment, a focus on patience grows the space in which capital can be applied. For example, the MacArther Foundation in the US speaks of "**Catalytic Capital"** which refers to patient investments that are structured as "debt, equity, guarantees … that accept disproportionate risk and/or concessionary returns relative to a conventional investment in order to generate positive impact and enable third-party investment that otherwise would not be possible" (MacArthur Foundation, 2019).

The big elephant in the room when it comes to patient capital in Australia, is that actually it is Government who traditionally has had the greatest degree of patience and the highest risk appetite. Whilst most commentators in Australia suggest that Government has a 'first mover' or 'catalytic' role to play in the growth of impact investment, fewer acknowledge that Government has long played a crucial role as an investor and a co-investor when it comes to applying capital for social and environmental impact. And this role is not just in responding to ‘market failures’ or picking up the pieces as the investor of last resort - but also in creating markets (think NDIS, Aged Care in recent times), and in shaping markets (think solar and renewable energy incentives and subsequent investment), and indeed in conserving for very long-term market and non-market outcomes (such as land conservation for generating ecological value).

“Evidence shows that the early high risk stage of the innovation chain, characterised by high capital intensity, is disproportionately occupied by public actors” (Mazzucato, 2016;p105).

What kind of patience is needed?
When it comes to defining patience, the emphasis has been on characteristics of capital - that it is about a longer wait for returns on the investment, higher risks and preparedness for illiquidity. But that is a narrow view of the types of patience needed if we are to skew impact investment into more transformational spaces.

Patience refers to four key arenas in transformational impact investment (see figure 1):

1. **Impact**: the focus is not on outputs, which can be relatively short-term (e.g. number of jobs created), but on outcomes and impacts (e.g. the development of quality jobs, and what happens as a result of them) which requires patience, particularly if the issues being addressed are complex.
2. **Breadth + Depth of Understanding**: timebound funds and, more broadly, a ‘deal’ approach to impact investment are illustrative of an implicit impatience. When there is an emphasis on ‘pipeline’, the investor focus can easily drift toward opportunity, transaction, and volume and away from the nuances of need and context. Patience is much more about developing a deep understanding of the issues and structures that underpin societal challenges, and then developing interventions and capital structures around them (not singularly, but in structured portfolio approaches) that

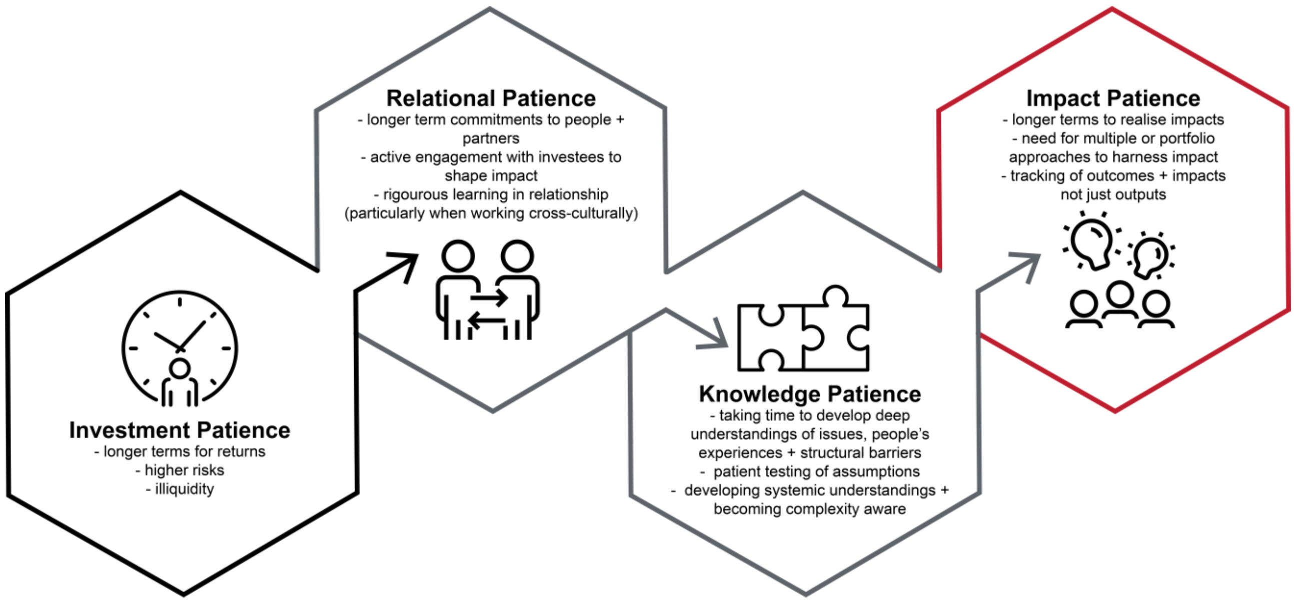

Figure One: Four Arenas of Patience in Transformational Impact Investment could begin to significantly impact on addressing the challenges.

3. **Relationship + Commitment**: in order to undertake significant impact investment with a patient approach, investors need to build long-term commitments and relationships with people experiencing the issues they wish to 'impact'. Too often we are still framing investors as the 'difference makers', when the proposition is right, without them having deep, long-term relationships with the people and organisations they are invested in. This means they are very often only scraping the surface of issues they actually hope to impact.
4. **Financial:** Patience relates to long-term commitments in relation to returns (both financial and impact), relatively high risks (which can be mitigated with the above forms of patience), and illiquidity. This financial patience holds in impact investment as it does in mainstream investments such as private equity.

What does it look like?

If we are to develop patient and transformational impact investment in Australia there are four ways in which we could begin. There are some existing examples within Australia, but certainly many more internationally that could point to how this could be done.

1. **Building greater impact and where possible, intergenerational impact into investment approaches.** Beginning with the impact to be created (rather than the supply of capital), enables the design of transformative outcomes over time. The investor is an active co-creator in interventions rather than a recipient of a proposal or pitch. For example, Pacific Community Ventures in

Pacific Community Ventures

Pacific Community Ventures innovative exit processes and employee on-ramp program help them to optimise impact throughout the investment process.

PCV has pioneered innovative exit planning processes such as 'equity set-asides' for low-income, non-management employees in SMEs within PCVs portfolio. This program builds in a plan to pay employees a cash payout through a wealth sharing plan triggered by an exit sale of a company. Employees thus have an opportunity for asset-building and an incentive for added productivity as they share in the wealth that is created on exit. The equity set-aside is built into the plan and execution of exit strategies where the company is sold to other investors. This extends the impact of their investment to provide economic opportunities for residents of underserved areas.

PCVs Employee Onramp program is designed to provide asset-building and support services to low-income employees of SMEs in the PCV portfolio. The program focusses on helping these employees enter the financial mainstream, build their financial capacity, build assets and access other essential services. This program is delivered via a network of partner organisations and helps to ensure that the PCVs impact extends beyond the investment and into transforming the lives of employees from underserved areas.

[see www.pacificcommunityventures.org and also Caplan et al, 2007]

"Long-term investing has never been more important than today. Many of society's most intractable problems - from addressing the environmental ills of the planet, to revitalising decaying infrastructure in developed and developing nations alike, to ensuring national security, to the hunger for innovation to stimulate economic growth - resist easy solutions. Rather, they can only be addressed with the thoughtful application of time and money" (Ivashina and Lerner, 2019; p.7)

California is using private equity to grow brick and mortar businesses in the region, with a focus on growing quality jobs, capacity of both employers and employees, and, most importantly, looking at how the investment vehicle can not only result in profits for the investors, but asset growth for the employees (see short case here). In Australia, a similar approach was used by Foresters Community Finance in some of the early work undertaken to grow housing opportunities for people with disabilities, and thereby explore asset transfer to a group of people who, as a cohort, typically have much less access to housing ownership.

2. **Moving beyond deals into impact portfolios.** Currently in Australia an emphasis on a 'deal' approach is creating a confetti landscape of impact investment where singular social enterprises or other vehicles are invested in (often with unrealistic expectations of what impact they can create), and few intermediaries exist who are prepared for a much deeper portfolio of investment focussed on IMPACT rather than returns. Perhaps it is time to explore how we could grow more impact by focussing on growing and deepening structured patient portfolios or ecosystems of impact. How could capital be cohesively invested to engage in multiple parts of any given system, recognising the timeframes and (financial) returns for different interventions within this holistic context will vary dramatically? The example of Blue Hub Capital illustrates this - and figure 2 suggests core focus areas for portfolios that

Blue hub capital

Started in 1985 as 'Boston Community Capital', BlueHub Capital's focus started in low income communities around Boston. Its focus remains on low-income communities, but its geographic footprint is now national. BlueHub Capital's focus is investing in "people and communities for an inclusive future". To date they have used an impact investment and social finance focus to prevent more than 800 foreclosure-related evictions, renovate 2 million square feet of real estate, build or preserve nearly 20,000 units of affordable housing, and create 4,440 living-wage jobs. They are also one of the largest solar providers to affordable housing in the US, having helped to generate 26.5 million kilowatts of solar capacity, saving low income families millions of dollars in energy costs (communitywealth.org). BlueHub has a place focus, and a futures focus - seeking to initiate economic futures that generate inclusive prosperity for all, and equitable prosperity that benefits particularly low-income people and communities. Their use of investment focusses on asset development (housing, property development that benefits communities), job creation, but also growing sustainability and resilience over the long term. They seek to not only invest in place, but stay in place in order to grow an inclusive future for local people (particularly those on low-incomes).

Since 1985, BlueHub Loan Fund has made loans totaling over $1.3 billion to communities across the US. They started with deep investments in Boston, and with the success of this portfolio (covering housing, healthcare, childcare, education, commerce, business, jobs, healthy food retail and sustainable energy), they moved to support other communities in the same way. Utilising a portfolio approach they are able to patiently invest across sectors and services to grow impact in place over time.

could grow transformative outcomes with the addition of patient capital. Given that not all investors may have the capacity nor the inclination to have this level of engagement, it raises the importance of intermediaries (not just fund managers) who do.

3. **Focussing on growing impact intermediaries with particular focus areas to enable a much more systemic approach to impact.** In the US, UK and Europe there are a growing number of intermediary organisations who have developed particular focus areas in order to deepen their impact. Community Development Finance Institutions, focussed on both places and particular cohorts, are examples of such intermediaries. They often partner with philanthropists, communities and entrepreneurs to layer and structure appropriate investment so that it can effectively create deeper impact. They also benefit from some key tax and regulatory structures that we don't have in Australia, but that have never really been appropriately examined in this context either.

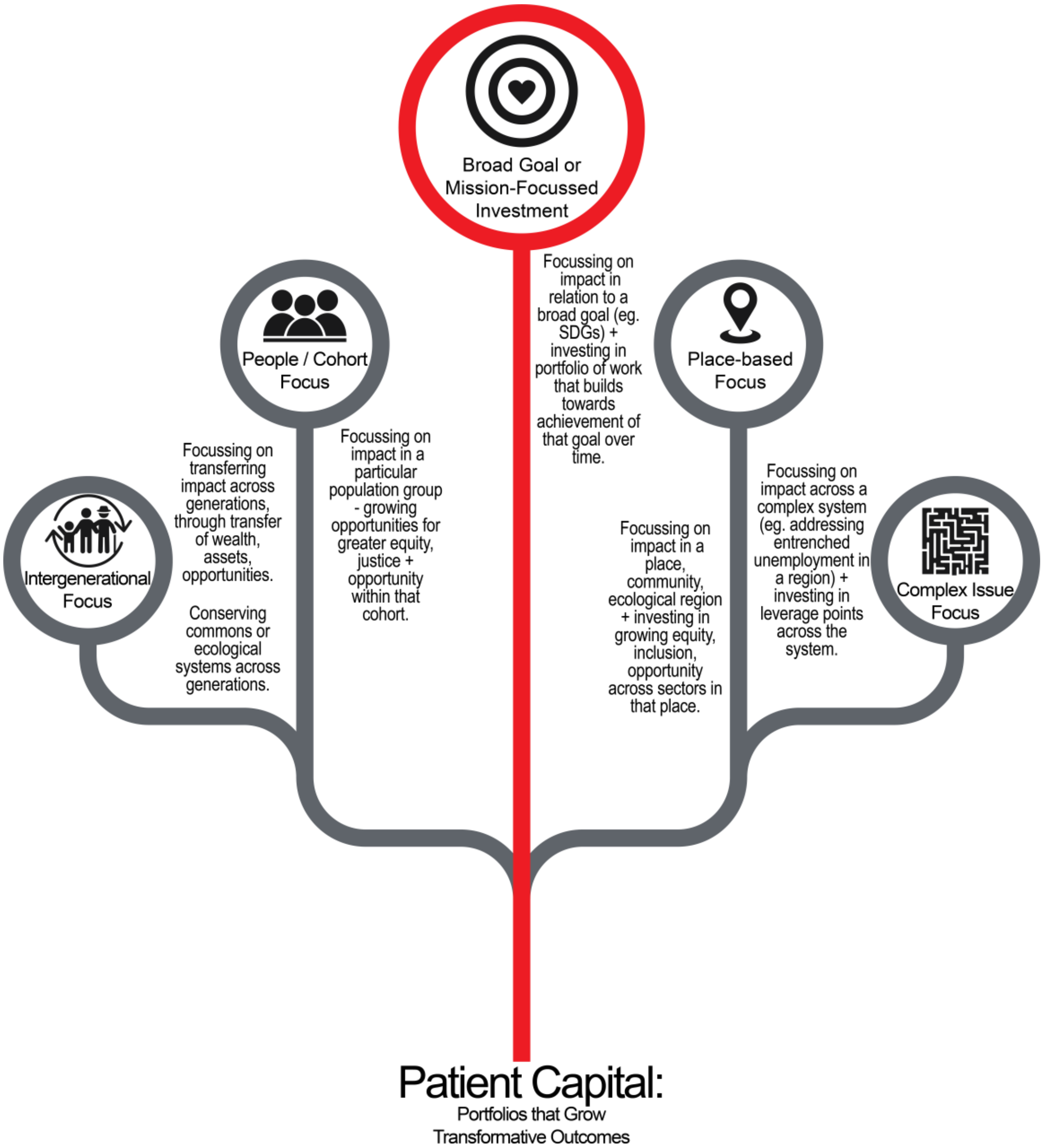

Figure Two: Examples of portfolios or ecosystems of investment that could grow transformative outcomes

4. **Moving beyond financial innovation into impact innovation.** Impact investment in Australia has been dominated by a 'banking' mindset, whereby the focus is on growing and structuring the supply of capital, and the orientation is set towards the investor rather than the impact. To shift this, we need to start to reverse-engineer from impact back into investment rather than the other way around. It is clear that we have patience when it comes to designing financial instruments. For example, the social impact bonds that have been tested in Australia have each taken much patience – extensive time and transaction costs to set up. The question is how we could shift this patience to a broader focus on designing effective and innovative impacts first, and then developing the right 'fit' of capital around achieving these impacts. This also has implications for the skillset of people working in impact finance, and ensuring financial competence is balanced with capabilities around engagement, impact, complexity and design.

In the current context it could be argued that there is more of a need for urgency than patience – that we need ways in which to get capital out the door to the people, businesses and communities who need it. This is, of course, very much the case. However, if responsiveness is actually to lead to impact over time, then building on 'patient' foundations is going to be important. For example, Nonprofit Finance in New York, in collaboration with Rockefeller Foundation and numbers of other philanthropic bodies, was able to set up a loan fund of $19M in 9 days to assist non-profit organisations with bridging finance, needed because of slowed processing of government funding due to lockdowns.

They were able to do this and will likely generate considerable impact not because of financial wizardry, but because they have patiently built relationships and knowledge of the sectors on which they are focussed that enabled them to move quickly and responsively when needed (see Bugg-Levine, 2020, https://tinyurl.com/ya9v7yjj).

Perhaps, a challenge to growing the patient mindset is the shift in mainstream investment practices moving the other way. It's interesting to note that the average holding time for an equity investment was 4 years in 1945, eight months in 2000, two months in 2008 and 22 seconds by 2011 (Mazzucato 2018). The combination of technology and financialization, has resulted in returns increasingly being linked more to volatility than value. This, alongside the persistent practices of leveraged buyouts, asset stripping, and share-buybacks (to name but a few) have fostered a culture around investment which is anti-relational, short-term, extractive and unconcerned with legacy or externalities – the antithesis of what patient impact investment is about. While it could be argued that these worlds are quite separate, the reality is that there is a significant, and growing, cross-over of people, organisations and practices between the two. We will explore this dynamic more, later in the series.

Finally, beyond mindsets and culture, we also need to acknowledge the reality that many investors seeking impact may face material constraints in relation to time, liquidity and risk. To grow the impact of impact investment, therefore, we also need to consider growing the supply of capital that is patient by design, and is able to provide a platform for other parts of the market. We previously discussed the critical and overlooked role of Government as a patient investor, but not all of these investment approaches are efficient or enabling. More can be done to facilitate purpose-specific pools of public-backed impact capital (such a wholesale funds), and also to create new pools of capital, sourced in ways that engender independence and long-term time horizons. Could a national endowment, or a micro-tax on stock trades, or a surcharge on property purchases be a way to radically increase the liquidity of patient capital? What incentives or assurances might be provided to other long-term investors to become more engaged in impact? These aren't questions that we attempt to answer in this series but they are enquiries that are worthy of thoughtful consideration. Just as we call for more engaged design from investors in interventions before allocating investments, we also advocate for more engaged design of the overall impact ecosystem in addition to growing the impact investment market.

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The Yunus Centre equips people with the know-how to navigate change and create positive, societal impact. We are interested in how a progressive, regenerative and inclusive future can be achieved through new models of innovation, entrepreneurship, and enterprise.

Specifically, we're focused on navigating impact-led innovation, developing impact literacy, growing the impact economy and fostering impact entrepreneurship.

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