Blog for Pioneers Post

Charly & Lisa Kleissner are philanthropists with a vision. They want to ensure humanity survives the crisis of finite resources and growing populations, and they're going to use the financial system to do it.

Their family's KL Felicitas Foundation (KLF) has been dedicated to this end for 15 years. Through it they work to change the global financial system, so that it serves people and the planet rather than harms them. It does this by stimulating the *demand* for impact capital by supporting social entrepreneurs and accelerators, working on the *supply* of impact capital through developing and supporting networks of investors, and influencing *intermediaries*—better enabling the flow between the two sides.

The foundation's portfolio of investments spans the impact spectrum (see figure below). Some are sustainable liquid investments focused on best ESG (environmental, social and governance) practice and achieving (or outperforming) market-rate returns. Others are impact-first investments focused on specific social issues, which often sacrifice returns in the process.

Figure 1: Impact investing spectrum

Their investment strategy has developed over time. The Kleissners made the decision in 2004 to give away the part of their fortune they did not need to live on and invest $10m of their assets for positive social and environmental impact. Their portfolio started with a mix of funds that screened out negative investments, micro-finance funds and cash deposits in Community Development Finance Institutions (CDFIs).

At the time there were very few investments that offered market rate returns and a 'deep impact', with most focused on the avoidance of harm or moral hazard rather than positive outcomes for people and planet. Despite this the Kleissners still pursued deep impact through program-related investments in individual social enterprises. These include such enterprises as SMV Wheels, which provides a rent-to-own service for bicycle rickshaw drivers in India, and MA'O Organic Farms, growing healthy organic produce while educating and training local young adults in Hawaii.

As time went on, more options for deep impact became available and KLF worked on growing the space. They helped set up Sonen Capital in 2011, investment advisors committed to impact as well as returns. Sonen still manages the liquid portion of their portfolio, invested in public markets. As an example, one of KLF's holdings, the Sonen Capital Global Fixed Income Strategy, invests in sustainable investments that display ESG leadership, and thematic investments focused on climate change adaptation and mitigation—such as green bonds or municipal bonds focused on waste management.

Core to Lisa & Charly's attempt to reform the financial system is evidence that investing responsibly can deliver returns—both financial and social / environmental. To prove this they've been at the leading edge of transparently reporting those returns. First in the 2013 publication by Sonen Capital of their financial returns, subsequently in our NPC 2015 publication of their social and environmental returns. And then this year, bringing the two pieces together in a joint NPC-Sonen Capital publication: *'In pursuit of deep impact and market-rate returns'*.

This is the first time an attempt has been made to publish, and compare the relationship between, the financial and social returns of an impact investment portfolio. The report also explores the impact of Charly & Lisa's broader support for the impact investment ecosystem, beyond their investment portfolio—such as creating and supporting accelerator programmes, first-time funds and investor networks.

And the results show that deep impact is being achieved—not across the whole portfolio, but certainly among their thematic and impact-first investments. The majority of investments are delivering on their own impact goals, whether that's serving 25.3 million financially under-served customers, providing clean cookstoves for 20,000 rural off-grid households in Africa and India, or permanently protecting over 117,000 acres of high conservation priority land.

Deep impact is not being pursued across the entire portfolio so that the portfolio, as a whole, can provide market-rate financial returns. And yet the sustainable elements of the fund are also achieving positive, if not deep, impact—such as demonstrating lower water use or carbon emissions than the benchmark.

Of course, pursuing deep impact comes with its own risks. A number of investments within the portfolio have not succeeded in becoming viable enterprises, despite strong impact propositions. In a few cases, KLF have had to fully or partially write off their investment. These mainly apply to KLF's program-related investments and reflect their risk-taking approach. We suggest that an impact investor without failures amongst their portfolio may not be reaching for hard-to-achieve impact. KLF have also divested from several organisations or funds that they didn't feel were generating adequate social returns, and reinvested in more impactful opportunities as the field has developed.

The portfolio, overall, is achieving market-rate returns. This is an essential part of the Kleissners' theory of change. In order to persuade other investors to adopt this investment approach, there needs to be evidence that you can achieve both financial returns comparable to standard benchmarks alongside achieving social returns. Only once enough evidence is amassed, across billions of dollars of investment portfolios, will the global financial system tip towards accounting for positive social and environmental impact.

The KLF portfolio has returned a net financial return of 2.75% pa since inception in 2005, outperforming the industry portfolio weighted benchmark by 37 basis points (these are the investments with reportable performance and exclude impact-first investments). The impact-first reportable portfolio, meanwhile, has returned a net -2.5% pa since inception.

Interestingly, the report shows that there is broadly an inverse relationship between financial return and impact practice (used as a proxy for impact achieved). The more liquid portions of the portfolio (public equity and public fixed income asset classes) have delivered higher financial returns but lower social impact, compared to the impact-first investments. Note that private equity financial returns are excluded from the analysis (not being reportable), which some may argue are delivering both high financial returns and deep impact. More data points are required before this can be proved.

The Kleissners are constantly looking ahead. And the challenge they've now set themselves is to create a 100% thematic impact portfolio, contributing to two major themes—climate change and social justice, with a floor of 0% financial return. Now that they have proved deep impact and financial returns are compatible across a portfolio, they want to illustrate what can be achieved without making losses, with the expectation of even greater impact, offering up their portfolio as a modern benchmark for a 100% impact portfolio for these themes. And they will continue to share their experience and results transparently to inspire and encourage others to rethink their investment decisions.