# How IFIs Work

*Occupying the space between traditional philanthropic giving and traditional market-rate investing, impact-first investments (IFIs) prioritize a desired impact on society or the environment while still generating returns that are typically, but not necessarily, below-market rate.*

## A portfolio-wide approach to impact

Philanthropic assets help to address the most pressing societal and environmental challenges across the globe today—from a growing affordable housing crisis to labor market shortages to the effects of climate change and beyond. This category of capital includes funding set aside for grants or charitable donations, money held in donor-advised funds (DAFs), family office resources, foundation endowments, and other vehicles.

The strategy for deploying philanthropic assets to address these challenges is critical. Most commonly, philanthropic capital is divided between two standard capital allocation "buckets": philanthropic giving and traditional investing—making investments with the intention of achieving risk-adjusted market-rate returns. Ultimately, these tools are both deployed toward the overarching goal of maximizing impact—with philanthropic giving deploying capital to make an impact today, and market-rate investments securing returns to deploy capital toward impact in the future.

"Impact-first investing" (IFI) is a third bucket that provides an additional tool to unlock and deploy capital into innovative and sustainable market-based solutions to our most complex societal challenges. Occupying the space between philanthropic giving and market-rate investing, impact first investments are investments made in private asset classes with the intention of achieving risk-adjusted below-market-rate returns in service of the primary goal of generating a social or environmental impact. They include everything from loan funds deployed to mission-driven organizations to catalytic first-loss capital to venture investments in impact startups and beyond. Organizations have increasingly relied on impact-first investments to build interventions that become self-sustaining—not reliant on grants—while also having the potential to attract investment capital to scale more quickly.

The important role of impact-first investing in an effort to maximize overall impact cannot be overstated. Even with modest allocations to IFIs, the impact of a philanthropic asset portfolio has the potential to be substantially greater than staying with an approach of only making market-rate investments and philanthropic gifts. This is due to the power of impact-first investments' ability to create impact while also recycling capital for ongoing impact.

The idea underlying impact-first investments is that if an institution explicitly—or even implicitly—allocates some of their capital to philanthropic objectives, they should prioritize the overall social impact of that philanthropic portfolio. To achieve that goal, one can use a combination of philanthropic giving, market-rate investments, and impact-first investments.

Market-rate investments allow the allocator of capital to maximize its resources for future philanthropy, and giving allows the allocator to focus resources directly on creating social impact. Impact-first investments, meanwhile, create some direct social impact and provide a financial return for future philanthropy. The critical question is how these impact-first investment opportunities trade off impact and financial returns—more specifically, in what circumstances an impact-first investment's combination of financial returns and social impact leads to preferred outcomes, compared to a conventional strategy of just giving and market-rate investments. This is particularly important as market-rate investments can at times be contributing to the problems one tries to address through giving—or, put another way, they can create a negative impact.

One of impact-first investments' primary advantages over philanthropic giving is that they earn a return that can be recycled into future projects—rather than only a one-time deployment with a negative 100% return. Meanwhile, impact-first investing's advantage over market-rate investing is that these investments deploy much-needed capital to high-impact initiatives that are unable to attract market-rate investments due to their risk levels or return profiles, though they still generate a return.

Accordingly, impact-first investing has shown tremendous promise. It includes investments in loan funds that provide capital to underrepresented communities at below-market interest rates, as well as equity investments in early-stage for-profit impact startups that are aiming to transform the health, education, and financial sectors for the better. These investments can prove out the impact and commercial viability of innovative new initiatives, reducing risk for other investors and thus catalyzing more funding for greater impact over time. There is also a "cost of not investing"—the idea that so many creative interventions will never get off the ground without this type of more patient capital. However, because allocators of philanthropic capital tend to focus on the two classic buckets of charitable giving and market-rate investing, the implementation of impact-first investing remains sub-scale—with significant potential for impact left untapped.

It is important to note that while IFIs can be powerful levers for addressing social challenges, they are certainly not always the right solution. In many contexts—including but not limited to humanitarian response efforts and initiatives without a viable revenue model—traditional grantmaking is more appropriate. Decisions between grantmaking and IFIs ultimately depend on the nature of the specific problem, the goals of the philanthropic investor, and—critically—their assumptions about return and relative impact between a given IFI and a comparable grant. The IFI Tool is designed to help philanthropic investors navigate these choices—not by prescribing answers, but by provoking thoughtful, assumption-driven analysis of what allocation approach best fits their aims.