Analysis of barriers to impact investing in Israel for JFN

by Leora Propper

December 2018
Analysis of barriers to impact investing in Israel for JFN | by Leora Propper

Background

The term “impact investing” was first coined in 2007 by the Rockefeller Foundation. According to the Global Impact Investing Network (GIIN), the formal definition of impact investments is investments made in companies, organizations, and funds with the intention to generate positive, measurable social and environmental impact alongside financial returns. Impact investing has become a legitimate and recognized investment practice among a small but critical mass of players and is being increasingly adopted by diverse types of organizations. The latest high-profile example is BlackRock, the world’s largest asset manager, which announced in early 2018 that in order to receive investment from the firm, companies will need to demonstrate that they positively contribute to society (1).

In the past, impact investors were placed in several distinct camps: either “impact first” or “financial first,” focused on either concessionary returns or market returns respectively. These either-or tradeoffs no longer describe the reality. Instead, impact investors are increasingly looking at their overall portfolios and individual investments across a spectrum that takes into account varying levels of risk, return, and impact and, in doing so, opening up new possibilities (3).

Figure 1: The US impact investing market evolution. (2)

Historically, foundations have mostly expressed their commitment to achieving social good by making grants - notwithstanding the establishment decades ago of the
related concepts of program-related investing (PRI) and mission-related investing (MRI). The recent development of a broad range of impact investment opportunities has created the option of using significant amounts of their investment capital to pursue their social objectives. Philanthropic foundations have played a pioneering role in catalyzing the impact investment market due to their ability to take risks in pursuit of successful social innovations that are often seen as excessive by mainstream investors (4).

Today, many foundations are thinking beyond traditional grantmaking to align more of their assets with mission in creative ways. Foundations have a wide range of approaches to risk, return, and impact. Many seek market-rate returns alongside social and environmental impact, while others prioritize impact and provide more flexible, risk-tolerant, and patient capital. These foundations use their capital to de-risk individual investments or markets and attract other types of investors, including those from the private sector and government who can offer much greater resources (5).

When innovative foundations assume more risk so that other investors can assume less, they increase the capacity for impact. Such cross-sector collaborations are driving the surge in impact investing. And more and more foundations have explicit mandates for leveraging additional dollars and enticing investors from other sectors to join them. With the growth of the impact investing sector comes a discussion about definitions, standards, measurement, and broader infrastructure. Foundations have an inherent interest in and ability to develop the impact investing ecosystem. At their core, foundations are more open, transparent, and collaborative than conventional investors, and by sharing their learnings - from both the successes and the failures - they allow the field to build on their experience. Some even publish their portfolios and investment holdings for all to see. With their focus on mission, foundations are particularly interested in understanding what's working and why from an impact perspective (3).
## The Impact Investing Spectrum

As mentioned above, nowadays investors regard their overall portfolio across a spectrum that takes into account varying levels of risk, return, and impact.

### Figure 2: The impact investing spectrum

![The impact investing spectrum](image)

Another way of looking at the impact spectrum is by addressing financial goals, impact goals, and intentions.

### Intentions and goals of organizations in the impact economy

<table>
<thead>
<tr>
<th>Approach</th>
<th>Traditional</th>
<th>Responsible</th>
<th>Sustainable</th>
<th>Impact-Driven</th>
<th>Philanthropy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial goals</td>
<td>Accept competitive risk-adjusted financial returns</td>
<td>Accept dis-proportionate risk-adjusted returns</td>
<td>Accept partial capital preservation</td>
<td>Accept full loss of capital</td>
<td></td>
</tr>
<tr>
<td>Impact goals</td>
<td>Don’t consider negative outcomes for people and the planet</td>
<td>Avoid harm</td>
<td>Benefit various people and the planet</td>
<td>Contribute to solutions</td>
<td></td>
</tr>
<tr>
<td>Intentions</td>
<td>“I am aware of potential negative impact, but do not try and mitigate it”</td>
<td>“I have regulatory requirements to meet”</td>
<td>“I want businesses to have positive effects on the world, and help sustain long-term financial performance”</td>
<td>“I want to help tackle climate change”</td>
<td>“I want to help tackle the education gap”</td>
</tr>
</tbody>
</table>

### Figure 3: Intentions and goals of organization in the impact economy

![Intentions and goals of organization in the impact economy](image)
The Israeli Ecosystem

There is evident global interest in impact investments over the world led by the US, the UK, and Australia. The Israeli market is still lagging behind but is gradually getting more organized and entering the second stage of market building. For comparison, the US market is in the final phase of the third stage of capturing the value.

Figure 4: Market development stages (2).

Israel's current impact investments market

According to Social Finance Israel, Israel's market in June 2018 included:

- ~ $250m impact investment capital (aligned with GIIN definition)
- ~ 200 social businesses
- ~ 20 social accelerators and incubators
- ~ 12 impact investment funds
- 2 nonprofit organizations engaged in microfinance
- ~ 600 NGOs (over $1m)
- 2 social bonds
- 3 local foundations entering the field
Until a few months ago, in terms of market readiness, Israel was a nascent market characterized by:

- a small number of players;
- few intermediaries;
- a lack of investment by institutional entities;
- few investment products.

In recent months things have started to pick up, and one can sense a momentum. The recent activity should be added to the long-standing activities of Israeli impact investors and social investment funds such as: Eytan Stibbe - development of infrastructure in Africa; Marius Nacht - health - tech; Noa Yovel - Maoz, - real estate and environment; Yoel Cheshin - credit card consumer-based communities and real estate; Yosef Abramowitz - clean energy; Daniel Friedler - urban renewal; Dualis, - employment in social businesses; Israel Venture Network (IVN) - social businesses; Impact First - technology.

Recent activities include:

- Edmond de Rothschild Foundation - The foundation encourages the building of the ecosystem of impact entrepreneurship. It recruited a designated staff member and launched a matching grant initiative. It also announced a 5% carve out of business profits to impact investments.

- Rashi Foundation - The foundation is working with Social Finance Israel (SFI) on an impact investment policy aligned with the foundation's strategy. The policy will outline the impact strategy including the risk-return-impact objectives.

- JDC - JDC, together with the funds of the National Insurance Institution of Israel, has launched Hackaveret, an acceleration program for social ventures. JDC is currently checking the feasibility of launching an impact investment fund.

- Bader Foundation - The foundation together with AJEEC (Arab-Jewish Center for Empowerment, Equality, and Cooperation) made a PRI of equity in the first-of-its-kind fitness center exclusively for Bedouin women in the Bedouin city of Rahat in Israel.
• Max M. & Marjorie S. Fisher Foundation - The foundation made a PRI of a seven-year 4% loan to Dualis social investment fund in Israel to fuel on-the-job training for at-risk youth by investing in retail social businesses.

• UJA Federation of New York - The Federation invested $1 million divided between two Israeli social investment funds: Dualis and IVN.

• UJIA- As part of their Social Impact Investment Initiative (Si3), the organization invested in a few social ventures such as “Al Sanabel”, a catering business, established to provide employment for single mothers who are below the poverty line and ”Koret” that provides Micro-financing for the Ethiopian Community.

• Elah Fund - A growth capital impact fund investing primarily in high potential, medium sized, revenue generating, and export oriented companies in Israel's Negev and Galilee regions.

• Bridges Israel - This social venture fund will invest in for-profit mission-driven businesses in Israel's most underprivileged communities as well as in businesses that aim to make an impact in the areas of health and well-being, education, and the environment. The fund secured a first close at $50m with a cap of $75m. Among their investors are two institutional investors: Discount Capital and Psagot Investment House Ltd.

• Newera - This impact investment VC fund is looking to close a $100m investment target by January 2019. The fund’s investment strategy ensures top-tier returns and the incorporation of environmental, social, and governance (ESG) best practices in portfolio companies, enabling measurement and report on the impact of the fund. It invests in five sectors: energy, healthcare, water, agri-tech, and ICT.

• Social Finance Israel (SFI) - SFI has expanded its activities to support investors and investees entering the market by providing the following services: consultancy, investment banking (initiating investments, connecting the parties, and accompanying the implementation), deal sourcing, development of measurement methodology, and others.

This is only a partial list of recent activities in the Israeli impact investments market, and we believe that this momentum will continue attracting more investors to enter the field, which will, in turn, encourage the involvement of more organizations.
This Paper

As Israel is a nascent market where the terminology is still vague and the barriers are high, there is still need for education work in order to boost confidence and competence. We understand that in order to define JFN’s role, we must first identify the barriers to impact investing in Israel. This paper outlines the main barriers and serves as a guideline for JFN’s programing regarding impact investing in Israel.

Methodology

We conducted interviews with 38 people representing various groups: local and foreign foundations; funders and professional staff members; younger and older generations; and professional players in the field. In terms of levels of engagement in the field, we tried to capture the whole spectrum—from believers who are totally engaged in the market to non-believers who have no real intention of engaging.

In this paper we do not name individuals; rather, we present the main themes from the materials collected and focus on the aspects that are most relevant to JFN’s potential role. Consequently, we present mainly perceptions and not evidence-based research.

Main Barriers to Impact Investing in Israel

1. Structural barriers

1.1 Lack of a suitable organizational structure for philanthropic activity
Philanthropic activity in Israel is not gathered under one designated organizational structure like the big, private US foundations, the endowment funds. Instead, the activity is structured and funded directly from individual wealth as a whole with no clear or defined allocation to philanthropy and usually based on a yearly budget. Unlike in the US and other countries, the Israeli regulator has initiated no tax incentives for establishing structures dedicated to philanthropic activity.
The big US foundations were the pioneers; they built the impact market using their investment capital (endowments) to pursue social objectives and enabled the development of the impact investment field. This activity brought other investors into the market.

The absence of a suitable structure for philanthropic activity in Israel denies local philanthropists an appropriate tax-effective vehicle for practicing impact investing.

1.2 Lack of sufficient tax benefits for impact investors

Israel, unlike the UK and the US, does not have tax incentives for any type of impact investments, except for philanthropic donations to nonprofit organizations. The UK is the global leader in the development of the impact investment field. They have used a range of tools to develop innovative financial instruments and to set up dedicated funds and social investment. The British government has established special legislative arrangements and tax breaks in order to incentivize private sector and philanthropic investment in social enterprises and other projects with social returns.

In the US, policy surrounding impact investments is marked by initiatives of the private sector and the public sector as well as cooperation between the two. The main method of facilitating impact investment in the US is the leveraging of public and private funds through tax incentive programs in order to increase capital for social projects and programs. The US federal government has created special regulations and financial instruments to provide incentives for impact investors, though individual investors do not qualify for the programs directly (8).

For grantmaking in Israel the only incentive to the Israeli funder is a 35% tax credit up to a limited overhead for contributions to nonprofit social organizations that have received a permit from the tax authorities (9). For investment in for-profit social organizations, there are no equivalent tax incentives. US-based organizations might be deterred from giving an interest-carrying loan to an Israeli grantee, as they are exposed to a 25% tax withholding on interest repayment.
In the US, the UK, and France there are many tax incentives as shown in Figure 5.

<table>
<thead>
<tr>
<th>Country</th>
<th>Program</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>UK</td>
<td>Social Investment Tax Relief (SITR) (2014)</td>
<td>The benefit receiver: private investors in social organizations (according to a set risks) and SIB investors.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Tax allowance up to 30% of the investment (must hold for 3 years). Differed capital gain tax if profit invested in social business until investment is realized. Capital gain tax exemption after 3 years on an investment in a social business.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Maximum investment - 1m £</td>
</tr>
<tr>
<td>UK</td>
<td>Community Investment Tax Relief (CITR) (2003)</td>
<td>The benefit receiver: any individual or company that have a UK tax liability that invest in CDFI for a period of at least 5 years.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Tax allowance - a tax deduction of a 5% of the investment every year for 5 years, so total benefit is 25% of the investment.</td>
</tr>
<tr>
<td>France</td>
<td>Investing in social businesses (2001)</td>
<td>The benefit receiver: an investor in a social business for at least 5 years.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>The benefit: a deduction of 18% on income tax or a 50% deduction on inheritance tax.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>As of 2017 the total direct investments in social business was €502m.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>The benefit: a tax allowance of 38% of the investment during 7 years.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>CDFI fund (under the treasury office), approves CDEs that may provide a loan or capital</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Since 2003, 750K jobs were created, support was given to building of 7.8 m sq. m of industrial space 5.8 m sq. m of office space and 4 m sq. m of commercial space.</td>
</tr>
</tbody>
</table>

Similar to start-up investments, impact investments are characterized by high risk and low yield compared to their risk profile, which means investors are often hesitant to invest in this type of product despite the important prospect of a social return. Providing an impact investment tax incentive increases the profitability of social investment for the investor and helps to increase the resources available for addressing social issues. The impact investment tax incentive reduces the cost of borrowing for social enterprises and minimizes the competitive disadvantage resulting from the obligation to promote social goals at the expense of maximizing profits.

### 1.3 Lack of incentives and supportive legislation to promote the activity of institutional investors.

Institutional investors are defined as organizations that invest on behalf of the public, for example, mutual funds pension funds and insurance companies. In Israel the regulator asks for a declaration of whether the institutional investor has considered social responsibility investment (SRI) aspects. In December 2017 the Capital Market, Insurance, and Savings Department of the Israeli Ministry of Finance issued an instruction to all institutional investors to declare whether, within their investment policy, they consider any SRI aspects and, if so, what they are.
Public money invested in pension funds and provident funds comprises one of the most suitable sources for social investment that yields long-term returns. Since this involves using the retirement savings of policyholders, it must be ensured that the money yields solid interest, as is customary in the capital market. One way of doing this is by spreading a government “safety net” for investors, guaranteeing a return on investment at a rate specified in advance, similar to initiatives for developing investments in the fields of high-tech or the development of transportation infrastructure (9).

1.4 Lack of tax incentives to social organizations and of adequate corporate structures
The main barrier to the development of social enterprises in Israel is the tax system which does not view commercial activity by a nonprofit organization as a legitimate way of creating income and therefore imposes income or profit limits, even if those revenues are not distributed. Another inopportune element of the Israeli tax system is the strict dividend policy applied to nonprofit organizations with profitable subsidiaries: the profits distributed to these nonprofits are taxed at 25%, whereas dividends between corporations are tax-exempt (9). In addition, the regulatory agencies in Israel have yet to recognize the special status of social businesses as entities that work for a social objective but aspire to yield an economic return. In order for these corporations to be able to recruit investors interested in an economic return on their investment, a new type of corporation must be added to the Corporations Law, namely, a corporation that works toward a social objective and is authorized to distribute a defined portion of its profits to its shareholders.

1.5 Lack of sufficient government funds
Government activity and funds were the main catalyst to the development of the market in the UK. The British government adopted many of the recommendations of a special taskforce established in the year 2000 to study the implementation of capital market and entrepreneurship practices to contend with social challenges. This innovative and creative approach is expressed in a number of ways including: establishing financial institutions for community development aimed at increasing local accessibility to capital; encouraging investments by foundations and public entities in social financing and investment entities; and providing economic and tax incentives that benefit social organizations that conduct business activity (9). One recommendation
from the taskforce resulted in the establishment of the Big Society Capital, the world's first social investment bank, a wholesale, game-changing model for stimulating social investment, for which the government set aside assets of £400m in dormant bank accounts (9).

In Israel very little has been done not only in terms of regulation and incentives, as mentioned above, but also in terms of the flow of government funds into the field. In 2015, two funds were awarded a government tender to establish and operate the Yozma Social Business Investment Fund. The tender was a joint effort between the National Insurance Institute, the Ministry of Finance, and the National Economic Council. The Yozma Fund provides investors and philanthropies with a unique opportunity to support social causes with significantly reduced risk. More specifically, by investing in the fund, the Israeli government mitigates the risk of private and philanthropic monies, which, in turn, attracts investments at market-rate interest.

The Yozma Fund's social mission is to invest in and mentor social businesses that focus on employment for deprived populations (youth-at-risk, people with special needs, etc.)

This kind of activity, although relatively small (government support of 20 million shekels), could encourage the development of the social business ecosystem in Israel. Similar initiatives could promote the establishment of other investable products in the impact investment field such as market-rate return funds, for-profit social ventures, and others.

When discussing policy and government involvement, it is worth mentioning that the Israeli government has not assigned an official responsible for the topic of impact investing.

2. Perceptive and cultural barriers

Most people feel uncomfortable with change: whether it's the fear of losing control, concern about incompetence, or uncertainty, the automatic reaction to change is resistance. In the case of impact investing, the resistance is higher, because the terminology is vague and most people don't have a clear idea of what it means.
2.1 Jewish Diaspora

2.1.1 Jewish philanthropy is considered risk averse, and it is thus more likely to prefer traditional grantmaking than to move on to impact investments in the form of PRIs or MRIs. In addition, as mentioned above, the impact investing market in Israel is still in its early stages and is more appealing to early adaptors than to traditional investors. Impact investment requires a proactive approach toward pursuing investment opportunities. The extra effort required to move from interest to action in impact investing can sap investor enthusiasm and confidence. Traditionalism also affects the roles assumed by family members and enforces the separation between philanthropy and business. This is relevant to family structures (different family members who head the business and the philanthropy) and to foundations (different staff for investment committee and grant activity and presumably little communication between the two teams).

2.1.2 For some Jewish philanthropists in the Diaspora, giving in Israel is associated to traditional Jewish giving and is mainly in areas relating to Jewish identity and the relationship between the Diaspora and Israel. It is challenging to build an impact investing strategy around these themes, as investment opportunities are scarce.

2.1.3 Federations are driven by lay leaders, and consensus is required when entering a new field. This means that the shift to impact investment is a long and slow process, as it requires changing the mind-sets of many people.

2.1.4 From a financial and business point of view, many wealthy Jewish individuals and investment committees in Jewish foundations and federations in the Diaspora do not consider Israel a target market for investments. From the perspective of a global portfolio management, Israel is a small market which is barely incorporated in diversified portfolios. This also harks back to conservatism; while Israel's economy has changed and strengthened over the last two decades, perceptions of it haven't.
Israel

2.2.1 Philanthropy in Israel is still young and considered far less developed than philanthropy in the US, the UK, and other developed countries. This is mainly because the wealth is young and doesn't yet provide a sense of financial security, high-net-worth individuals are in the spotlight and exposed to criticism, and the socialist ethos still drives the belief that the government is responsible for providing its citizens with social services. Philanthropy isn’t yet part of the wealthy Israeli’s identity. Israelis are entrepreneurial and bring this spirit to their philanthropy which results in establishing and funding their own nonprofit organizations (the so-called “My NGO syndrome”). Many wealthy families do not undergo a strategic process of defining values and vision and have no mission statement. Implementation of the pure impact models requires, however, clear values. The fact that Israeli philanthropy is still young also means that most wealth is still held by the first generation who tend to be risk averse and thus less likely to act in the impact investment market.

2.2.2 The mind-set of absolute separation between the financial investment pot and the philanthropic pot is common among wealthy individuals. When presented with impact investing many philanthropists ask themselves how for-profit investments fit in philanthropic theoretical frameworks. It is hard for them to digest the fact that when doing good one can also gain profit. The same goes for the existing social organizations that rely on donations and grants for their operations.

2.2.3 The way in which the Israeli public perceives local philanthropists might also have an effect on their motivation to make for-profit investments. In a survey conducted last year it was shown that the public believes that self-interest factors as opposed to altruist factors motivate the giving of local philanthropists. In fact, 71% of the participants in the survey linked negative factors to local philanthropy \(^{12}\).

2.2.4 Some investors approach impact investments with skepticism, presuming that if it does social good, it is probably a bad investment or simply a
greenwashing attempt. This is reinforced by the fact that there is no clear understanding of the spectrum of impact or of the fact that there is room for concessionary investments and market investments.

2.2.5 The culture of the “startup nation” is evident in the way Israeli investors approach all fields, and impact investing is no different. The venture capital (VC) approach looks to technology to change a paradigm, while the impact world is more conventional and looks to make exiting solutions accessible to disadvantaged populations. The VC approach isn’t always right for impact investing, also because it is difficult to implement an impact measurement methodology on R&D based companies.

3. Awareness - market education

A successful impact-investing marketplace engages a minimum of five market segments: philanthropists, investors, nonprofit social ventures, for-profit social ventures, and intermediaries and providers of professional services (e.g., community development financial institutions, attorneys, accountants, investment advisors, and consultants). All of these require unique education and mentoring before embracing impact investing for their diverse needs (13).

3.1 Philanthropists and investors

There is room in Israel for raising awareness among investors. As shown in Figure 6, the awareness and activity of Israeli investors is low.

![Figure 6: Israeli investors' awareness and activity](image)

While we believe that awareness among investors has grown over the past year or so, there is still a need for education to boost their confidence and competence. The fact that the definition of impact investing is vague and that...
there is no clear understanding of the field deters investors from entering the market. It is necessary to adopt a clear terminology and to comprehend that impact investing is represented by a spectrum of combinations of social impact and financial return.

The diversity of impact investing strategies and types of capital (from concessionary to market-rate) confuses many prospective market participants, who may wonder whether this new field is akin to traditional philanthropy or to finance - two fields with different goals, vocabularies, and tools at their disposal. For foundations that are new to impact investments, the overwhelming questions are where to begin and whom to trust (1).

When discussing the awareness and education of investors, there is also a need to address the barriers posed by the different gate keepers. Be they in-house or external investment managers, professional foundation staff, trustees, or other external advisors, they all tend to resist implementing strategies with which they are not familiar. This is why the donor’s will to engage in impact investments is key.

3.2 Social ventures

A lack of both awareness and capacity characterizes the current landscape of social ventures.

In terms of investees (the receivers of the capital), impact investment can be directed to both nonprofit and for-profit ventures, as long as they can produce a financial return (15). When it comes to the former, they lack the ability to build a financial model; the latter, on the other hand, have trouble incorporating impact methodology into their business models.

Most social ventures don’t have the tools to become a target for impact investors, and there is a need to expand the capacity of entrepreneurs and to support the development of impact-focused businesses. This includes establishing the right legal framework and other fundamentals of investment readiness. The development of cost-effective ways to prepare social ventures to become investor-ready - through a capacity-building process that includes outreach, education, and technical assistance - is an essential part of growing
the industry. When talking about the investment readiness of existing nonprofit ventures, there is a need to develop the following:

- An infrastructure for ongoing measurement and evaluation, providing the flexibility to make changes (for example, CRM system).
- A database that will enable comparison between control groups and program beneficiaries. In Israel, unlike in other developed countries, the data held by the government and other public authorities is raw, which means that organizations have to allocate resources and develop expertise to process it. In addition, the data gathered by the authorities is not broad enough to provide a basis for a variety of social programs.
- Financial expertise within nonprofit ventures.
- The provision of short-term outcomes in sectors which only provide long-term impact.

In order to build this capacity within social ventures, there is a need for capital. It is, however, very hard to secure grants for capacity building; while this is true for traditional programs, it is all the more so for for-profit programs which are relatively new to the world of philanthropy.

In addition, even when one overcomes the problem of investment readiness, the pool of social ventures that are focused on social impact is not diversified and the variety is limited. This lack of social ventures across diverse impact themes is especially acute when it comes to themes such as Jewish identity, which is a major theme for Diaspora Jewish foundations and federations.

3.3 *Intermediaries and professional service providers*

There is a global bottleneck when it comes to translating client demand into capital deployed. This is due to the fact that many financial advisors lack experience in impact investing. Advisors with too little knowledge to confidently recommend investments tend to avoid doing so and instead steer interested or potentially interested clients away from the field. Intermediaries link investors, investees, and stakeholders and provide them with innovative solutions and services. They can also facilitate the emission of structured financial products, help to reduce the costs of impact investing, and offer advice and help in
structuring deals and managing funds. A number of intermediaries can connect impact investors with these impact-driven enterprises by offering tailored services such as research, fundraising, certification, evaluation and impact measurement, business incubation, business acceleration, and legal services. (15)

4. Capacity building and associated transaction costs

4.1 Measurement tools

The most prominent feature of impact investing is its focus on measuring the social and environmental return that it generates. In response, there has been much effort to develop effective measurement systems, but confusion remains around the notions of “non-financial return” and “impact” and their practical assessment (16).

When addressing the measurement and evaluation of a social investment, one should look at a value chain to understand the difference between outputs, outcomes, and impact, where “impact” is seen as the measurable and identifiable change to key outcomes.

<table>
<thead>
<tr>
<th>Input</th>
<th>Activities</th>
<th>Outputs</th>
<th>Outcomes</th>
<th>Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>Resources</td>
<td>Concrete actions</td>
<td>Tangible products and services from the activities</td>
<td>Changes resulting from the outputs</td>
<td>The combination activities, outputs and outcomes, adjusted for what would have happened anyway, actions of others, and for unintended consequences</td>
</tr>
</tbody>
</table>

Figure 7: Impact value chain (16).

Most current measurement processes present outputs rather than outcomes and impact that require composite data analysis processes. The difficulties associated with obtaining the data, analyzing it, and monitoring changes was described earlier when discussing capacity building in social ventures. Although most grant activity in Israel is monitored and evaluated, only a small
fraction is actually measured by outcomes and impact. This means that before engaging in impact investing that requires a clear measurement methodology, measurement capabilities should be built both on the investors’ and the investees’ sides.

There is a variety of impact measurement and management practices - such as the IRIS Users Registry, Navigating Impact, the Impact Management Project, aggregated reports, and individual case studies by various organizations - but most are hard to implement. Many investors build a proprietary measurement model for each investment, which makes it hard to create a benchmark and compare between investments. Impact measurement thus remains a work in progress and an industry priority. In fact, the fragmentation of approaches to measuring and managing impact emerged as a top challenge in a recent GIIN survey. The lack of a standard approach is problematic for three main reasons. First, it demands extra time and effort from investors and asset managers to define, articulate, and comprehend the potential and actual impact of investment opportunities. Second, it prevents rigorous aggregate analysis to understand and compare the impact achieved by different investors and strategies. Third, it places additional burdens on investees, who must often report differently to each investor (1).

4.2 Transaction costs

While aggregated data provide little evidence of additional costs, impact investment might result in higher short-term transaction costs than traditional investment because of the implementation of rigorous social and environmental reporting requirements and additional due diligence (DD) processes (15). As indicated, there are a few aspects to the excess cost incurred by impact investment:

• Combined financial and social impact DD and monitoring - From the perspective of a funder or foundation, the support required for an impact investment is greater than the support required for grants, as it involves financial and social input and tracking. In many cases engagement in impact investing requires recruiting designated staff members or using external advisors, both of which raise costs.

• Intensive legal DD for structuring the investment - Most transactions are
fairly small (in comparison to traditional investments), which makes the burden significant.

- **Measurement tools and infrastructure** - Expertise and resources are required in order to properly measure the social impact.

**For foreign investors, investment in Israel is even more complex and costly**, as it evolves two legal systems, two languages, and geographical distance from the investment. In an impact investment in Israel, as opposed to a grant, there is usually more than one party to engage with, and the difficulty is thus amplified.

There are two factors that help tackle the excess cost aspect: first, the cost is likely to go down as the portfolio expands and expertise is gained; and second, impact investments, unlike grantmaking, are expected to generate returns and the excess cost should be viewed as a lower return in comparison to grants which generate no return. When looking at the invested capital, impact investments can generate higher transaction costs than similar private equity or venture capital investments. The lack of an enabling infrastructure can inflate these costs; networks are underdeveloped, and the lack of widely accepted and reliable social metrics makes the tradeoff between financial and social returns difficult to assess (15). Likewise, the lack of intermediation services can raise the transaction costs due to fragmentation, the complexity of the deals, and misunderstanding of the risks (15).

5. **Other**

5.1 **Perspective on the role of philanthropy**

Some philanthropists view impact investment as defying the role of philanthropy and fear the cannibalization of traditional grantmaking. Hyping market solutions to “do good” can create a bubble - especially if there is a gap between expectations about financial and social returns and actual performance - thus diverting capital away from philanthropy and decreasing the grants allocated to social and environmental challenges (15).

Larry Kramer, president of the William and Flora Hewlett Foundation, is a well-known critic of impact investment. In his opinion, a foundation that puts grant
dollars into non-concessionary investments (in the form of a program-related investment or PRI) is squandering its resources. He believes that funds to support nonprofit organizations are scarce and that we have not come close to exhausting all the good that the nonprofit sector can accomplish with support (17).

When addressing the deployment of investment capital (endowments), the question of the effectiveness of the impact investment approach becomes significant, asking whether the social returns generated by non-concessionary impact investments are greater than the social returns that would be generated by grants made with higher returns on the endowment (17).

5.2 Lack of reliable research and evidence on financial performance

Credible data on risk and return could help both current and future impact investors better identify strategies that match their desired social, environmental, and financial criteria (15).

A lack of evidence, proving that one can actually gain financial return (both market rate and below market rate) while establishing social impact deters investors from investing. This is especially true in Israel, where the market is young and investments aren't “old” enough to show solid results as opposed to projections.

Recommendations

When addressing the barriers shown in the paper, we decided to present the recommendations in groups according to JFN’s role in to promoting them. We believe that JFN should focus on impact investing as a philanthropic strategy rather than as an investment strategy. It should be remembered that JFN is not a professional content body in the field of impact and actually possesses no implementation tools.
JFN related recommendations

1. Awareness and education

As shown in this paper, a lack of awareness and knowledge, perpetuated by vague terminology and “buzz,” is still a major barrier to impact investing in Israel. The activities within this category are relevant to most JFN members, as different activities can be offered to different members according to their exposure to impact investing and their level of knowledge.

- **Webinars and conferences** - exposing funders to the market, demystifying the definitions and terminology, and introducing the approach of impact investing as a spectrum of possibilities rather than one narrow definition. These activities are within the current scope of JFN's activity and are an extension of our ongoing conferences and activities.

- **Learning groups** - allowing funders to participate in in-depth consecutive learning of the field, using case studies and professional lectures focused on the ways in which philanthropy can impact. This activity may range from a few single workshops to a long-term and comprehensive course, according to members' needs. It is not currently within our scope and will require additional resources and collaboration with a professional body that can facilitate the learning.

JFN, as an international organization, has a unique position serving as a bridge and a source of knowledge for foreign foundations in planning their overseas investments. In such, JFN Israel will support foreign investors, who seek knowledge and guidance with regards to making PRIs and MRIs in Israel.

2. Network – interest group

The approach of networks, as a form of sharing knowledge, is common in the field of impact investment. Networks such as TONIIC, a global action community for impact investors, help to establish groups that are not only for learning but also for practical application. The network platform can also promote connections between international funders, who might be more experienced with impact investments, and local funders, who might be more familiar with the social venture and investment opportunities.
Two types of networks are possible:

- **A fit-all network** - This network will offer a few levels of activity for JFN members who are engaged in impact investment: shared learning (case studies, best practices, and lectures), shared alignment (members' updates) and, at the highest level, shared action (share deals).

- **A professional network** - Members who are highly engaged in impact investment might desire a separate network with common goals to increase the percentage of impact investments in their portfolio. This will be an exclusive group for members who have a target to invest a few precepts of their portfolios in impact investments over a few years.

### 3. Donor Advised Fund (DAF)

DAFs are investment vehicles set up by nonprofits to allow individuals to make irrevocable, tax-deductible grants. The DAF's assets are invested and then distributed over time to qualifying charities. DAFs create a suitable structure for philanthropic activity with a built-in tax benefit, a designated vehicle that is currently missing in the Israeli market. One of JFN’s main objectives for 2019 is to establish the first Israeli DAF.

We believe that incorporating an impact investment strategy in a DAF is the best way to bring new capital into the field. It will also enable JFN to focus on one big mission that will serve two objectives: increasing both philanthropic and impact investment activities in Israel.

JFN intends to establish this DAF as a subsidiary company in order to facilitate a proof of concept, and we will then pursue the required legislative changes. In the first stage, under the current legal structure requiring a high level of liquidity and a very limited level of risk, impact investments will be incorporated via publicly traded companies. Our measurement of the portfolios' impact will be conducted via the UN's SDG (sustainable development goals) scale. In order to supplement this scale and improve the tools for portfolio management, the asset manager will also incorporate high ESG standards. This will allow a broader range of investments while improving the portfolios' risk management tools. We recommend adopting a policy excluding investment in “sin stocks” (industries like alcohol, firearms, tobacco, gambling, etc.).
In the second stage, once legislative changes are made, the DAF will enable long-term private market investments, and the impact strategy will be implemented in the private market as well.

**Non JFN related recommendations**

1. Toolbox and databases

   As the field in Israel is young, **not enough sources of information are available for investors** regarding investment targets, legal frameworks, measurement tools, and other tools. Following are the tools required.

   - **A marketplace map** - This will outline the players in the field: the investors, social ventures, and intermediaries. This should be updated constantly. A more advanced tool is an “impact classification” system that helps investors match their financial and impact objectives to the right products.

   - **A database of social ventures** - This will outline the ventures active in the field, creating a kind of “Startup Nation Central” for social impact ventures.

   - **Measurement tools** - New indices and matrixes to be used for advanced grantmaking, outcome-based philanthropy, and impact investments.

   - **Off the shelf legal documents** - Documents required for investments such as term sheets, loan agreements, and others.

   - **Case studies according to social theme**

2. Policy and regulation

   **One of the main barriers to investment in Israel is structural, namely, a lack of incentives, government funds, and appropriate structures for investments.** We believe that large local impact investors can promote policy that will ease the access to impact investing. In order to leverage the activity, it should be done in **collaboration with the Israeli National Advisory Board on Impact Investing.**

   In addition to the recommendations presented, we believe that in order to promote the ecosystem further research and discussion is needed.
Bibliography

12. The public’s perceptions towards philanthropy, ERI and The Institute for Law and Philanthropy Tel Aviv University, June 2017.