

# The changing landscape of social-impact investing

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During the age of entrepreneurship, the gap between rich and poor grew rapidly. New business models directing capital in a more purposeful, moral way can help change that.

**Entrepreneurs who saw their ideas** turn into billion-dollar companies over the past several decades are now increasingly looking for ways to direct capital toward the goal of making other people's lives better. In this interview, McKinsey alumnus Sir Ronald Cohen speaks with McKinsey global managing partner Dominic Barton about how the thinking has changed around raising capital for the benefit of society at large. This discussion is excerpted from the video series *What happens next*—usually available only to McKinsey firm members—in which Barton has in-depth conversations with colleagues and outside experts on topics relevant to our clients.

## Interview transcript

**Dominic Barton:** Sir Ronnie Cohen. I could talk for the whole session about what he's doing, but suffice it to say that he is one of our most illustrious alumni. Today he is the chairman of the Global Social Impact Investment Steering Group and the Portland Trust, something that he founded himself. After leaving McKinsey he cofounded the global private-equity firm Apax Partners, which everyone should know about. He has also launched a whole series of investments around impact investing. Thank you for being with us. I thought we'd start at a broad level on capitalism.

**Sir Ronald Cohen:** My view about capitalism is that it has evolved greatly in the course of my career. We've seen, of course, the age of entrepreneurship. When I started in the firm in 1969, big companies were the thing. But it was obvious that small was going to be beautiful, because innovation was more easily and more successfully carried out by smaller organizations. I realized that the gap between rich and poor, which I thought would be helped by entrepreneurship, was actually being exacerbated—not that you didn't create a lot of jobs and you didn't make economies higher growth through entrepreneurship and innovation—but somehow, the way the capital was being allocated meant that the rewards to capital were much greater than the rewards to labor, and the gap between rich and poor got bigger and bigger.

I began to interest myself in why we had been so versatile at developing ways of funding those who want to take risks in order to make money but had failed to find mechanisms for raising capital for those who want to help others, putting it very, very simply. As I worked through the reasons, it became apparent to me that something quite fundamental was going to have to change in our capitalist system. And I can now see, 17 years after I started to look at this, that this paradigm shift is going to disrupt the models of entrepreneurship, of big corporations, of philanthropy, and of government.

**Dominic Barton:** And what dimensions do you see?

**Sir Ronald Cohen:** It's beginning to be apparent to me that business entrepreneurs—not all of them, but many of them—are, in their effort to solve these types of problems, going to create business models that can grow faster than the mainstream economy would allow them to grow *because* of the social impact, and of course, they can attract greater talent. And at some stage, they will probably have a lower cost of capital because they will be perceived as not having threats that companies that disregard their social and environmental consequences would have.

**Dominic Barton:** Do you mind giving an example?

**Sir Ronald Cohen:** In 2010, we developed, in the UK, the first social-impact bond, as it's come to be called. We said, "Look, we will raise some money from investors who are driven to try and achieve risk return and impact—to help prisoners, 60 percent of whom return to jail within 18 months of their release, particularly younger prisoners"—to the extent that we can reduce the number beyond the threshold of 7.5 percent; below that, it would be a philanthropic donation. The greater the reduction, the greater the yield. And you can get 1 to 13 percent return. The punch line, Dom, is government is paying about one-third of the savings in the first year from preventing these young people from going to prison. So you have a mechanism here that can work on prevention of social issues. You can prevent people from going to jail. There are, today, 74 social-impact bonds across the world, in 18 countries, addressing 14 different social issues: dropout rates from school, dropout rates from university, prevention of type 2 diabetes, homelessness, teenage pregnancy. Dom, if I'm right, over the next several decades, the flows of capital within our whole system are going to be directed in a more purposeful way, from the point of view of society. Not just because people feel a moral imperative, as the millennial generation does, but also because it's going to become the key to being a leader in your business area. □

**Dominic Barton** is the global managing partner of McKinsey. **Sir Ronald Cohen** is the chairman of the Global Social Impact Investment Steering Group and the Portland Trust.