Remarks delivered by Sir Ronnie Cohen
Impact Economy Foundation Lecture

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It is a great pleasure to be with all of you today at this inaugural lecture at the Marshall Institute with my close partner in impact, Kieron Boyle, who is its first professor of the impact economy, and to launch here the second edition of my book *IMPACT*.

It is natural that impact should be taking root at the LSE which was established 130 years ago by Beatrice & Sydney Webb to implement a new approach to fixing social issues based on measurement and rigorous data. They too believed that social progress does not come about by accident but is achieved by design and supported by measurable standards. Their insistence on empirical data, rigorous evaluation and standards for public service delivery is reflected directly in the impact movement's outcomes-based contracting, social impact metrics and rigorous evaluation frameworks. The impact movement's emphasis on modern impact measurement mirrors the Webbs' insight that "the right measure is the foundation of the right remedy." So, in many ways, the founders of the LSE are genuine precursors of impact.

Fixing the future is, obviously, a constant challenge in human progress. The Webbs were followed by Keynes, who shared their desire to improve the human condition. He innovated by managing the economy, with governments adjusting incentives within the economic system, pulling the levers of interest rates, money supply and government spending to maintain full employment and prosperity.

Both the Webbs and Keynes accepted that Adam Smith's "invisible hand of markets" was a powerful force for increasing the prosperity of a growing population.

If we fast forward to today, what do we see?

We see free markets thriving. They are driving life-improving tech innovation at breakneck speed, financed by a powerful $10 trillion investment engine called venture capital and private equity. Our economies are creating untold wealth for those who play a role in tech innovation and in financing it. Venture capital, private equity and NASDAQ, the only stock exchange in the world that caters to ambitious loss-making growth ventures, have created a powerful ecosystem that serves innovative risk-takers across the world.

We also see that the resulting wealth creation has led to globalisation, bringing the fast industrialisation of emerging countries, China, India, and countries in Africa and Latin America. Rapid industrialisation has brought its own consequences, pushing environmental pollution to planetary limits, and economic inequality beyond the levels of the 1920s. This inequality has accelerated since the 1970s. For example, the average CEO's salary was 40 times the average employee's 40 years ago. Today it is 347 times.

A century ago, the consequences of huge economic inequality proved dire, economically as well as politically, and they precipitated populist authoritarian governments, intolerance, civic violence and ultimately a catastrophic world war.

What are today's circumstances bringing to the fore? They are bringing the realisation that we are doing all we can to manage our economies for growth and employment, but that we have ignored the negative consequences on society and planet which have become unbearably high. That the incentives within our economic system drive profit without concern for the negative impacts created on society and the planet. So how do we maintain growth and employment, contain negative impacts and generate positive ones at scale?

That is the purpose of the transformative field of impact, in which all of us here are interested. Looking around I can see many people who are engaged in it as impact leaders, investors, executives, entrepreneurs, philanthropists, government officials and, most importantly, as talented entrepreneurs, executives and consumers whose preferences have shifted in favour of companies that do good, and so began to change the behaviour of businesses as well as investors.

The field of impact began to emerge at the beginning of this century. It seeks to provide the answer to our current predicaments. Not surprisingly, since capital is the lifeblood of capitalist economies, it started with the search for financial innovation that could attract investment to social entrepreneurs and purpose-driven organisations that strive to improve lives. Early efforts culminated in 2010 with the invention by Social Finance, here in the UK, of the Social Impact Bond (SIB). For the first time, that year, a reduction in the numbers affected by a social challenge, in this case reoffending by young prisoners leaving Peterborough jail, was tied to a financial return for investors. Over seven years, social delivery charities reduced recidivism by 9% and investors received their £5 million investment back plus a return of 3% a year from the Ministry of Justice.

Now, there are over 300 social impact bonds in 40 countries contributing well over $500 million to funding Outcomes Partnerships that tackle over a dozen social issues. Financial markets have grasped the opportunity in outcomes-based finance at massively greater scale than philanthropists and governments. Sustainability-linked debt, where interest on a company's borrowing falls if targeted social and environmental impacts are achieved, represents today a $1 trillion pool.

The invention of the social impact bond, and of impact venture funds such as Bridges that preceded them, prepared the way for the creation in 2012, by the Cameron government, of the social investment bank advocated by the Social Investment Task Force I chaired in 2000. Better Society Capital (BSC) was established with £400 million of unclaimed assets in banks, supplemented by £200 million from the UK's leading commercial banks, to act as a capital wholesaler for funding social purpose organisations. Over the past 13 years, BSC has catalysed the growth of a £10 billion impact sector in the UK.

At the same time, the Cameron government launched the G8 Social Impact Investment Taskforce that gave birth to GSG Impact which is now driving the implementation of the impact agenda in 50 countries. It also established the first modestly-sized outcomes funds to institutionalise outcomes commissioning. This was followed in 2018 by the creation of the $1 billion Education Outcomes Fund (EOF), created by Gordon Brown, myself and Amel Karboul, who will be participating in today's panel. EOF has deployed to date $130 million to improve the lives of half a million children in Africa. It is expanding into numerous African countries, pursuing its ambition to help 10 million children achieve a better education. Results in Sierra Leone suggest that outcomes-based initiatives are saving a year of learning.

The UK government has now taken a bold step in scaling outcomes funds. It has committed £500 million to the Better Futures Fund, which aims to attract matching funding from local authorities and philanthropists to improve the lives of children blighted by entrenched challenges such as lack of education and family care. Evidence to date suggests that outcomes-based commissioning costs half of traditional fee-for-service procurement. The advantage for governments is that they measure outcomes rather than activities, pay less, later, and attract impact investment to help fund social progress. I am delighted that the UK government has also established the Office for the Impact Economy, in the Prime Minister's office, to drive implementation of the impact agenda.

The emphasis on reliable impact measurement, which characterises the field of impact, passed the most significant milestone when impact accounting was launched last year. Using AI and machine learning, the International Foundation for Valuing Impacts published 100,000 environmental value factors covering nearly 300 locations across the world. These factors enable businesses, investors, consumers and governments to translate into money a company's emissions, water pollution and consumption, soil erosion and waste, making these impacts comparable with one another and with profits. Importantly, IFVI also designed value factors for social impacts. The invention of impact accounting will mark, in my view, the watershed between our current "selfish" economic system and the impact economies we need to fix our future.

There is an interesting historical parallel with the 1930s. Following the Wall Street stock market crash of 1929, investors realised they had been investing with no idea of the real profits companies were making. At that time, each company could set its own accounting rules, there were no auditors to verify numbers and companies could squirrel some of their profits into hidden reserves without shareholders knowing. The crash led to the effort to establish generally-accepted accounting principles (GAAP) that all companies would use and to introduce the use of auditors. When GAAP accounting was discussed in Congress, there were angry remonstrations that it would spell the end of American capitalism. In fact, the opposite proved to be true. The trust created among investors by full transparency led to the huge growth of investment in shares. The situation in the 1930s mirrors our situation today. Investors have channelled $30 trillion into Environmental, Social and Governance (ESG) investing to deliver desired impacts alongside profits with no idea of what impacts were actually delivered. The introduction of generally-accepted impact principles (GAIP) for impact accounting will fix that.

There is another striking historical parallel. Prior to the 1950s, investors measured only financial returns. Of course, risk was always in the background, but no one had tried to measure it. Then, Professor Markowitz, and his University of Chicago colleagues, showed that measuring risk simply involved analysing companies' share volatility, which is how much they tend to go up and down on the stock market. This insight brought new thinking like risk-adjusted returns and portfolio diversification. If venture capital is riskier, but delivers a disproportionately higher return, then its addition to a portfolio enhances performance. The measurement of risk completely transformed investment portfolios and opened the door to venture capital which funded the Tech Revolution, as well as to investment in emerging countries, which funded globalisation.

Beyond environmental considerations, where social progress is concerned, we have come to realise there is a limit to the redistribution of income and wealth governments can achieve through the tax system without harming economic growth and employment. By bringing transparency to the social impacts companies create relative to their competitors, we spur a race to the top. Comparing different companies' employee salaries with the sector average, the minimum wage and the living wage, gives us insights about their social impact performance. As AI threatens mounting layoffs, a company's contribution to society through training and upskilling its employees can now be measured. Ethnic and gender representation can be valued in economic terms and compared with peers. By expressing social and environmental impacts in money terms, we create incentives for companies to compete in satisfying the preferences of consumers and investors for companies engaged in doing good.

Taken together, these innovations provide the tools impact economies need to generate wide prosperity, on one hand, and social and environmental benefits on the other. Using them, investors and businesses can move decision-making away from risk-return to risk-return-impact, and governments can use them to spend more wisely, supplement cash-strapped budgets and achieve better outcomes.

Financial markets anticipate big changes. It is no accident, therefore, that global impact investment, defined as investment that intends to create beneficial impacts and measures them reliably, has passed the $2 trillion mark. Impact accounting is on its way to rewiring the $30 trillion ESG market that became tainted by greenwashing. When it does so, 15% of financial markets will be creating positive impacts alongside profits. Evidence shows that a tipping point is reached once the 10% mark has been passed, so impact economies are now within our grasp.

I was privileged to be a pioneer in the Tech Revolution that changed the world. I have a sense of déjà vu as I compare it with the Impact Revolution. The second wave of the Tech Revolution, driven by AI, is creating powerful new tools to deliver positive impact globally. Where AI meets impact is where the new Apples and Microsofts will rise. Tesla is the first example of this, the it achieved a trillion-dollar valuation in less than 20 years by putting environmental impact as the distinguishing feature of its cars.

AI and machine learning are making possible the delivery of positive impacts at a global scale that was previously unimaginable. It has become possible to customise the education of a million students taught at the same time. Something similar is also true for health diagnosis of patients across the globe, for transport with driverless electric cars, for every sector. This time round, disruption will come from tech and impact converging. The Impact Revolution is harnessing the AI revolution to disrupt business and investment models in radical ways that already echo the disruption caused by the microchip 50 years ago.

The Impact Revolution will be successful both because of the business opportunities it creates and also because it is the only way to tackle our massive environmental challenges and social inequalities. Impact will fix the future by attracting entrepreneurs, consumers and investors to high growth new sectors where companies do good and do well at the same time. It changes our economic system to align economic incentives with social and environmental ones. It fixes the flaw in our economic system, which incentivises the pursuit of profit alone. It enables our whole economies to engage in generating social and environmental improvement alongside profits.

Adam Smith was prouder of *The Theory of Moral Sentiments,* which was about altruism in guiding human action, than he was of *The Wealth of Nations*. Had he known that we would be measuring impacts in money terms, like profits, in the future, he may well have combined both his works and written about impact as the invisible heart of markets that guides their invisible hand.