ASIA HOUSE

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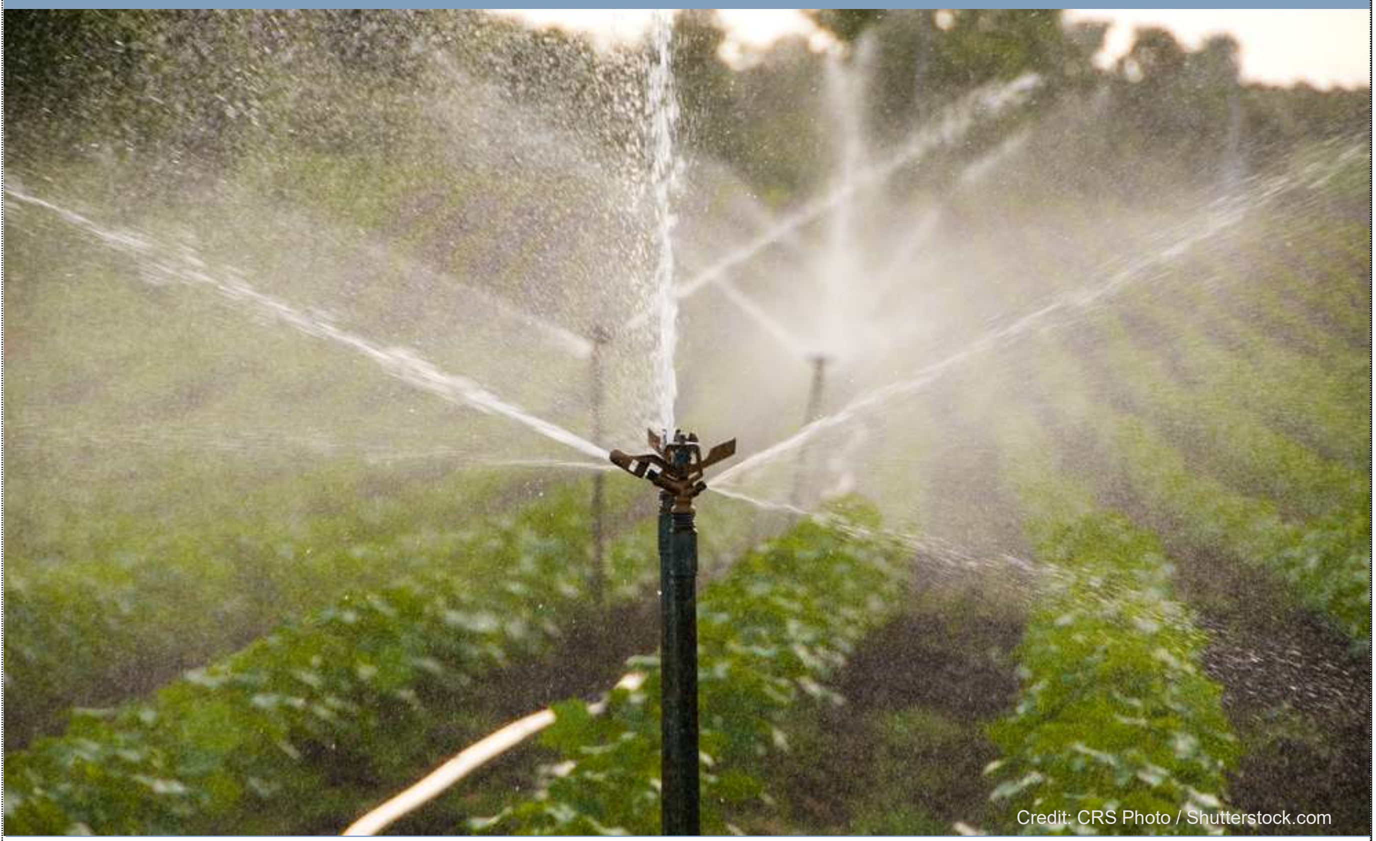
IMPACT INVESTING



Impact Investing: From upstream to mainstream

With special focus on South and Southeast Asia

Next week – on 12 October 2017 – leading Danish business newspaper Børsen is staging one of the first conferences on impact investing in Copenhagen, focussing on "Danish investments and global megatrends". The conference is one of many on this subject right now: last month, over 600 delegates attended the *Sankalp Southeast Asia Summit* in Jakarta and next month, Sydney is hosting the third *Impact Investments Summit for the Asia Pacific region*.

This Asian focus in no coincidence. Given their rapidly increasing populations and vast need for social investment, emerging markets – especially in South and Southeast Asia – have become the focal point for many impact investors.

The purpose of this Asia House Briefing is threefold:

- To shed light on the fast-growing market of impact investing in South and Southeast Asia.
- To highlight some of the complexities relating to impact investing.
- To pave the way for an Asia House seminar on impact investing early 2018.

Impact Investing on a roll

Impact investing is perhaps the strongest upcoming trend in the financial sector. Proponents argue that impact investing is fuelling the rise of finance as a force for good, paving way for development that is both profitable and sustainable. It combines the best of two worlds, delivering social and environmental benefits AND returns on investment.

Underlining the prospects of profitability, conventional investors are now engaging. TPG, BlackRock and Bain Capital have launched impact funds, while Goldman Sachs Asset Management have acquired Imprint Capital, an impact-investment firm. Institutional investors such as Zurich Insurance, the AXA Group and Australian HESTA, have entered the field, as have the world's largest pension funds, TIAA of America and PGGM of the Netherlands. These large players are bringing scale to what was once considered a niche.

According to the Global Steering Group on Impact Investing, the global market for impact investments will grow to USD 300 billion or more by 2020.[1] Other sources boldly estimate the market to reach USD 500 billion – 1 trillion globally over the next decade.[2]

Defining Impact Investing

The *Global Impact Investing Network* (GIIN) defines impact investing as *"Investments made into companies, organizations, and funds with the intention to generate social and environmental impact alongside a financial return"*. Furthermore, GIIN highlights *investor intention* and *measurability* as core characteristics to impact investing; i.e. actively pursuing a positive social or environmental impact and being able to document this impact in a transparent and accountable manner.[3]

While this definition seems clear cut, definitional squabbles still plague the impact community. How does *Socially Responsible Investing* (SRI) fit into the general framework of impact investing? What about "moral screening", where investors avoid sectors such as weapons, oil and tobacco? And how does "integrated" investments, that take environmental, social or governance (ESG) considerations into account, fit into the general framework? These disagreements make it hard to gauge the true extent of impact investment.

Another area of dissent is the question of financial returns. The GIIN-definition imposes no upper limit to the expected returns on impact investments, yet others maintain that *expectations* of a less than

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[1] *Impact investing: Purpose-driven finance finds its place in India*; McKinsey & Co. (September 2017)
[2] www.impactinvestmentsummit.com (Sydney, 2017) > *About us.*
[3] *Annual Impact Investor Survey 2017* (Seventh edition), Global Impact Investing Network (GIIN)

market rate is core to impact investing, as *"few solutions that meet the fundamental needs of the poor will get you your money back"*.[4]

Perhaps the greatest challenge to impact investing is the issue of measurability. One analytical approach divides this process into four steps.[5]

1. *Estimating impact*, conducting due diligence to assess the potential social return before committing to an investment.
2. *Planning impact*, choosing the metrics and methods used to monitor a program's effects.
3. *Monitoring and analysing impact*, once the program is underway.
4. *Evaluating impact*, measuring the social consequences after the program concludes to assess portfolio performance.

Yet, impact investing continues to be marred by inadequate and unstructured measurement approaches. Standardized methods exist, e.g. *Impact Reporting and Investment Standards* (IRIS) and *Global Impact Investment Rating System* (GIIRS), but they tend to focus on operations rather than products: "*There have been few efforts to evaluate the actual outcomes of market-based social enterprises. The absence of data and analysis makes it difficult for impact investors to assess the social impact of the enterprises they invest in".*[6]

This is a major issue. Lacking or unpredictable output measurements could prevent impact investment from realizing its full potential and dilute the label "impact investing".

Categories of Impact Investing

For a more nuanced understanding, impact investments can be divided into subcategories based on three different attributes that reflect fund strategies:[7]

A. Impact focus (explicit/implicit)
B. Investment stage (seed/early/growth)
C. Target financial returns (concessionary/commercial)

Based on these attributes, impact investments can be categorised into four distinct groups.

1. **Finance First**: *Implicit impact, growth stage, market-rate returns*

Finance First invest in frontier and emerging markets, usually established companies in proven sectors, that adhere to environmental, social and governance standards. *Finance First* form the bulk of impact investments from private investors, as they are perceived to carry the lowest risk.

2. **Balanced Growth**: *Explicit impact, growth stage, market-rate returns*

Balanced Growth funds focus on companies engaging with poor social groups either as customers or suppliers, providing essential products and services such as energy, education, healthcare, sanitation and affordable housing.

3. **Balanced Early**: *Explicit impact, early/seed stage, market-rate returns*

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[4] Stanford Social Innovation Review (24/1-2012): *The Trouble with Impact Investing*
[5] Stanford Social Innovation Review (16/5-2016): *How Impact Investors Actually Measure Impact*
[6] Stanford Social Innovation Review (Fall 2013): *When Can Impact Investing Create Real Impact?*
[7] *The Impact Investment Market in South and Southeast Asia: Market Snapshot – Impact Investment Funds*, Palladium (February 2017).

Balanced Early funds are early stage companies without fully validated business models. Their business models could either have been tested in other regions, such as providing affordable housing to bottom of the pyramid customers, or be completely new innovations.

4. **Impact First:** *Explicit impact, early/seed stage, concessionary returns*

Impact First funds support the most pioneering and untested business models. Fund sizes are the smallest and fund team members tend to be based in the region and near their investees.

The rise of Impact Investing

According to the latest GIIN report, *The Annual Impact Investor Survey 2017*, impact investing is presently growing at double-digit rates:[8]

Key indicator	**2015**	**2016**	**2017 planned**	**16-17 %**
Impact investing sum	$15 Bn.	$22 Bn.	$26 Bn.	+17%
Impact investing projects	7.551	7.951	9.557	+20%

According to the investors interviewed for the GIIN-report, sectors meeting basic needs such as housing, energy, financial services, food and agriculture, and healthcare, comprise the bulk of asset allocations (see table below). They also reported that most of their investments had either met or exceeded their expectations for both impact (98%) and financial performance (91%).

Sector	**%**
Housing	22
Energy	16
Microfinance	12
Fin services	10
Food & agriculture	7
Healthcare	6

The investments sampled in the GIIN report were roughly divided between developed and emerging markets. However, the future seems to lie with the emerging markets, with its vast demand for social investments only partially met by local governments, paving way for the private sector. Especially Asia, with its high population density and strong human capital, is seen to have potential, as enterprises will be able to increase capacity and provide services to scale.[9] A fair group of the investors interviewed for the latest GIIN-report plan to increase their activity in South and Southeast Asia.

The McKinsey report on India (2017)

India is the main target for impact investing in South Asia. Between 2010 and 2016, India attracted USD 5.2 billion in impact investments, benefitting an estimated 60-80 million lives. Half the investments came from mainstream funds, the other half from 50 dedicated impact investors.[10]

The McKinsey study highlighted three trends shaping the future market:

1. **Diversified and complementary sources of capital:** Conventional Private Equity and Venture Capital firms are increasingly engaged in impact investments.

[8] All data in this section is based on, or quoted directly from *The Annual Impact Investor Survey 2017* (GIIN)
[9] *Impact investing: Purpose-driven finance finds its place in India*; McKinsey & Co. (September 2017)
[10] *Impact investing: Purpose-driven finance finds its place in India*; McKinsey & Co. (September 2017)

2. **Bigger ticket sizes:** Firstly, several companies in healthcare etc. have matured, increasing the ability to absorb larger investments. Secondly, demonstrated profitability in the social sector has improved the ability to raise capital. Thirdly, emerging collaboration between impact and conventional investors.
3. **Diversifying sector spread:** Investments in sectors such as education, healthcare, and agriculture have all grown, at the expense of financial inclusion (microloans etc.) and clean energy, that traditionally dominated the sector.

According to Toshan Tamhane, senior partner at McKinsey and co-author of the report, "*India is one of the world's biggest markets for impact investing"* and expects India to *"absorb USD 6-8 billion of (impact) capital annually by 2025",* a sixfold increase from the USD 1.1 billion invested in 2016.[11]

The Palladium report on South & Southeast Asia (2017)

Written by *The Aspen Network of Development Entrepreneurs* and funded by the Australian government, the Palladium report analyses the investment market in select Asian countries, especially Bangladesh, Cambodia, Indonesia, Laos, Myanmar, the Philippines, Sri Lanka and Vietnam.[12]

Compared to the McKinsey-report, the Palladium report has a more tempered view on the prospects of impact investing on the emerging markets of Asia: *"The impact investment market in South and Southeast Asia is nascent and fragmented. Few global funds are active in the region and those that are, tend to invest only a very small portion of their portfolios in the region. Smaller regional funds are struggling to both make early stage investments and help build investable SMEs through supporting incubation activities".*

Of course, regional differences exist. Thus, Indonesia attracts the highest level of impact investments and Sri Lanka, Laos and Myanmar the least. According to the report, countries with a "*more developed SME ecosystem and more local investors investing in seed and early stages*" are more successful in attracting impact investments.

Perspectives

Despite the varying degrees of optimism reflected in the reports above, the level of impact investing in South and Southeast Asia is most likely to increase in the years to come. The reasons are manifold: A steady increase in impact investing on a global level, the increasing importance of the Asian economies, an abundance of capital, an ever-growing population and continuous need for social investments, and increasing demand by investors for social responsibility, a greater ability by South and Southeast Asian countries to absorb impact investments viz. a growing SME-ecosystem etc.

But what are the prospects on a more detailed level? And how to proceed? What are the specific barriers to growth and how can they be solved? Who are the main stakeholders? And what role do they play? And finally, the essential dilemma of all impact investing: How does one balance the ever-increasing demand for social responsibility with a continuous demand for high dividends?

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[11] Livemint, 17/11-2016: *Impact investing in India could touch $6-8 billion by 2025*

[12] *The Impact Investment Market in South and Southeast Asia: Market Snapshot – Impact Investment Funds*, Palladium (February 2017)

These will be the questions asked and answered when Asia House sheds light on impact investing next year.