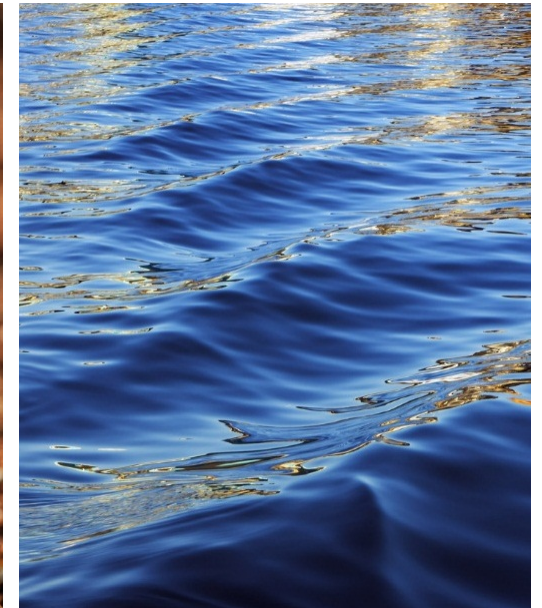


# Investing for Sustainability

Mobilizing Private Capital to Achieve the SDG

Prepared for 2020 Strategies, LLC

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## What is the current problem?

- The UN estimates that USD 3.9 trillion per year will be needed to achieve the Sustainable Development Goals (SDGs) in developing countries.
- There is a financing gap of USD 2.5 trillion annually that cannot be met by the public sector and philanthropy alone.

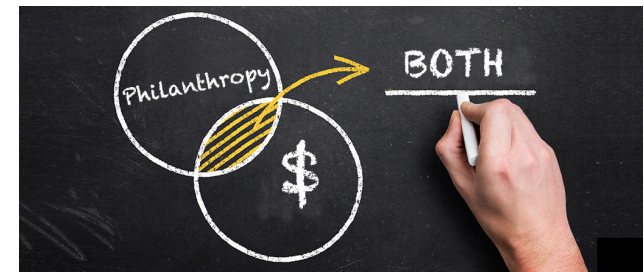


- Two new strategies for leveraging and deploying capital to address the world's development needs have been created over the past decade:
  1. Innovative Finance
  2. Impact Investing

## What is innovative finance?

**Innovative Finance:** the use of funds and other vehicles to blend private and public capital in the service of international development objectives that go beyond traditional spending approaches by either the public or private sectors, such as:

1. New Mechanisms for raising and pooling private and public revenue streams to scale up or develop activities for the benefit of partner countries
2. New revenue streams assigned to developmental activities on a multi-year basis
3. New to address market failures or scale up ongoing developmental activities



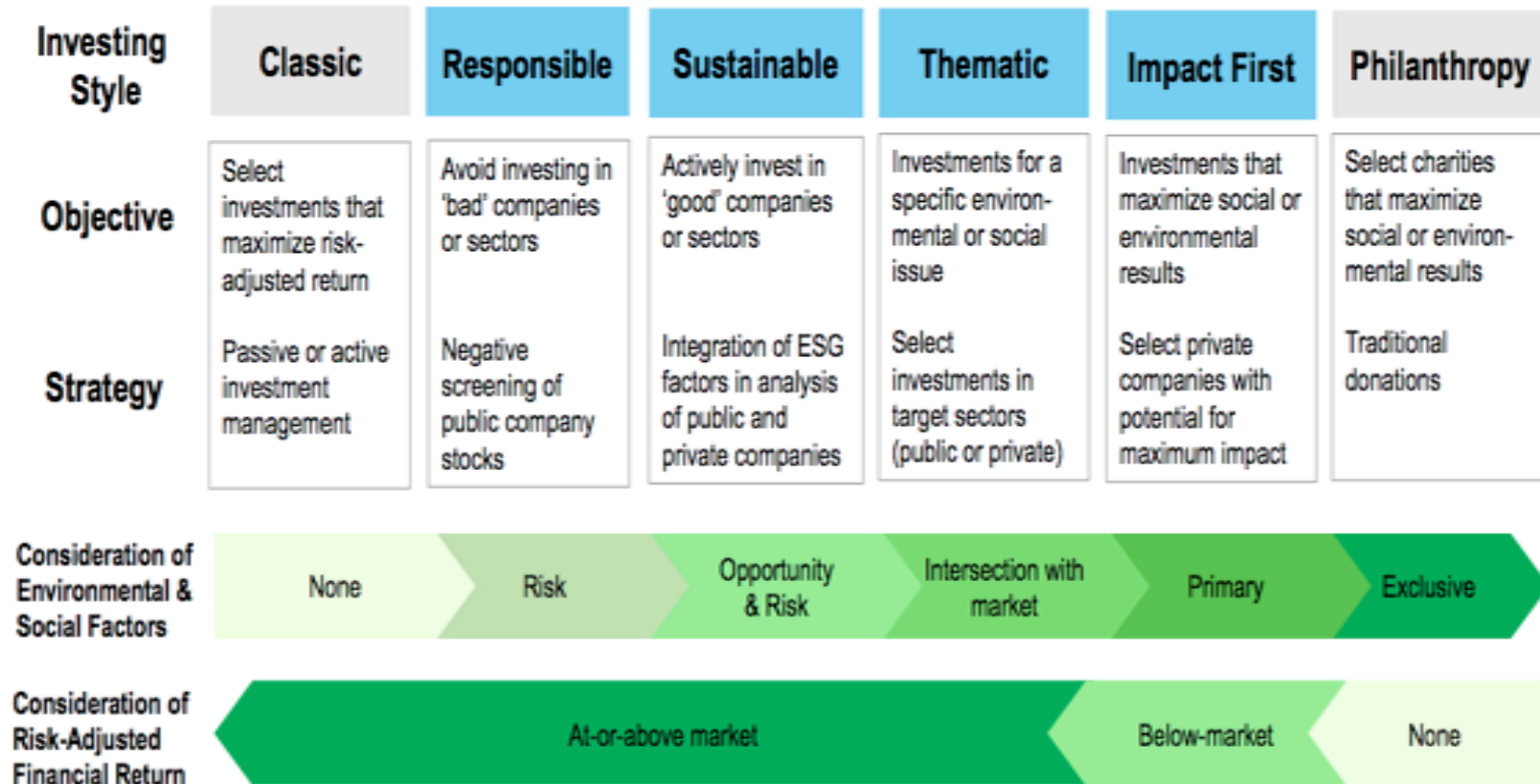
# What is impact investing?

**Impact investing:** making investments into companies, organizations, and funds with the intention to generate and measure social and environmental impact along financial return.

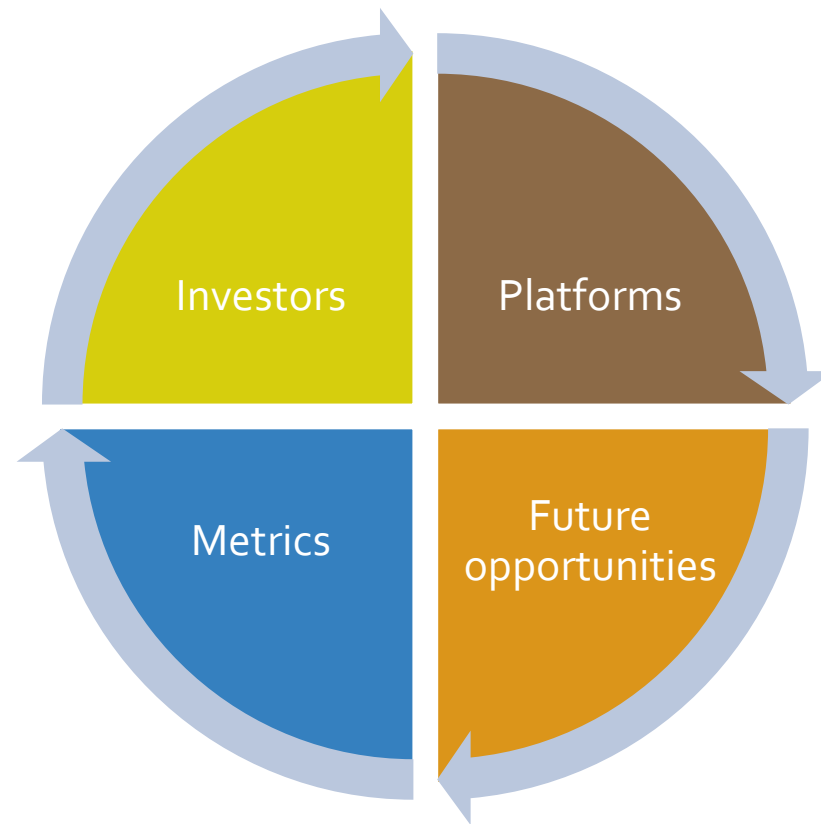
The lines that define what is and is not impact investing are fluid as Investors are motivated by a variety of reasons and seek various impact and returns objectives from different levels of risk.



## A spectrum from classic investing to philanthropy

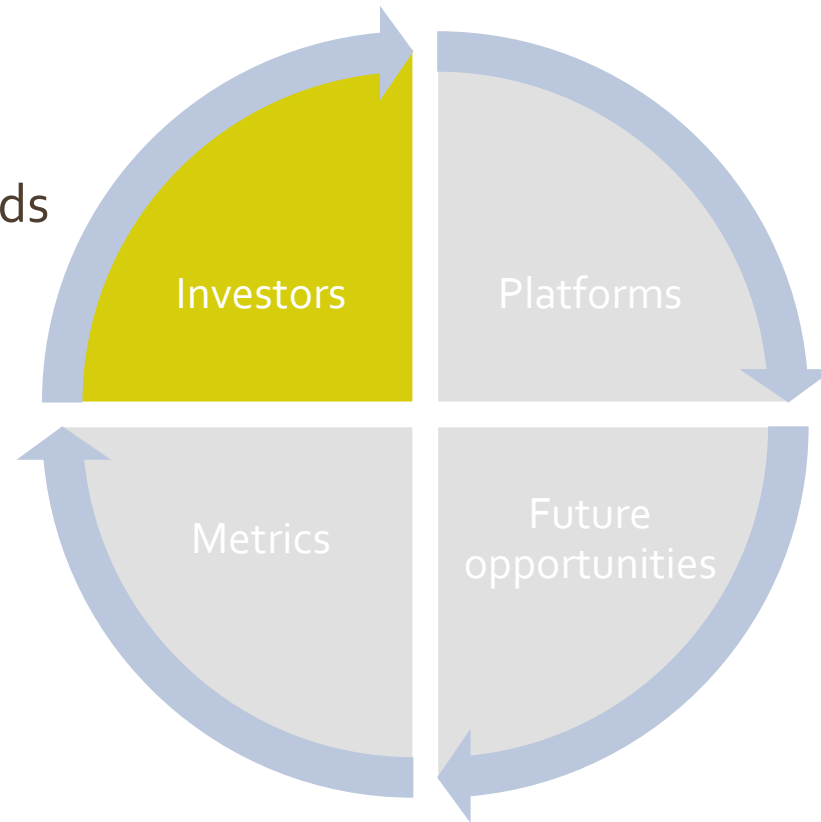


## Areas of focus



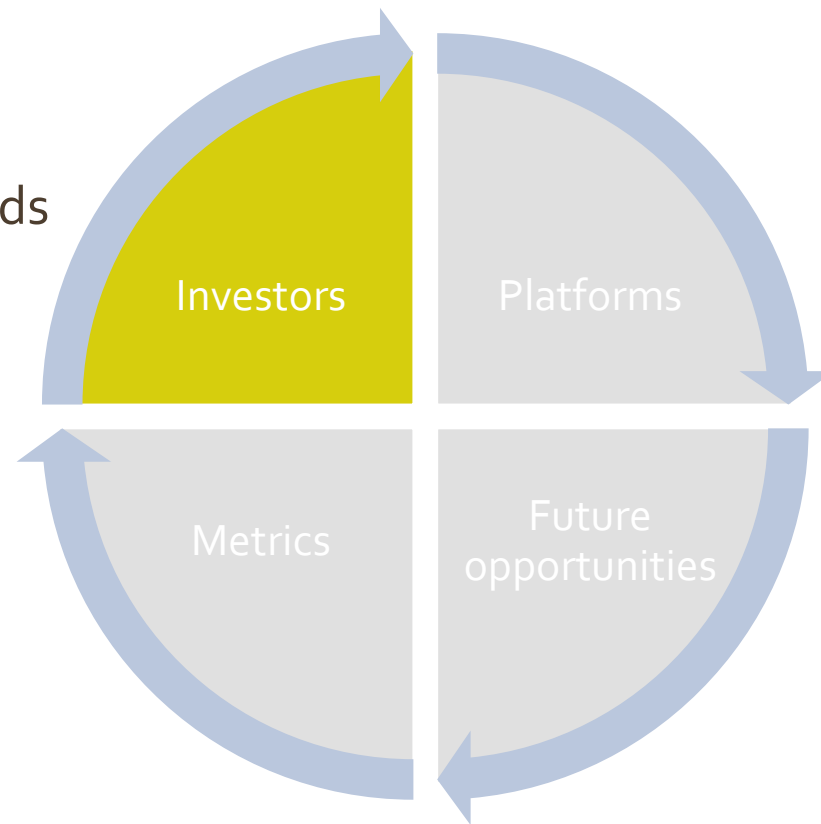
## Areas of focus

- Profile
- Types of Funds
- Challenges



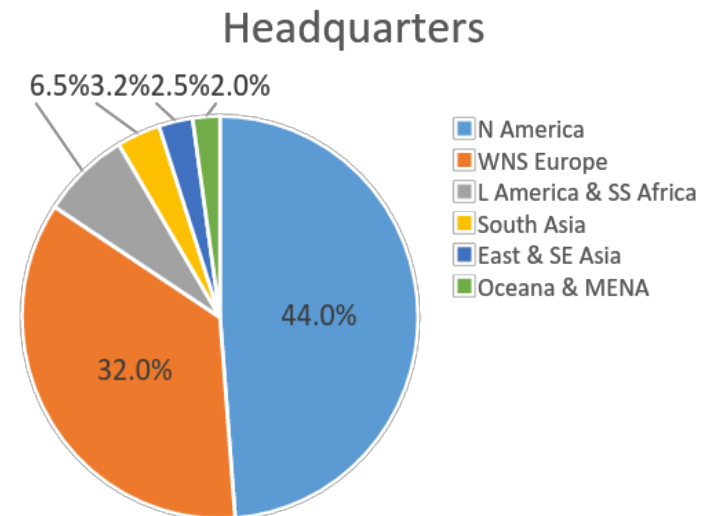
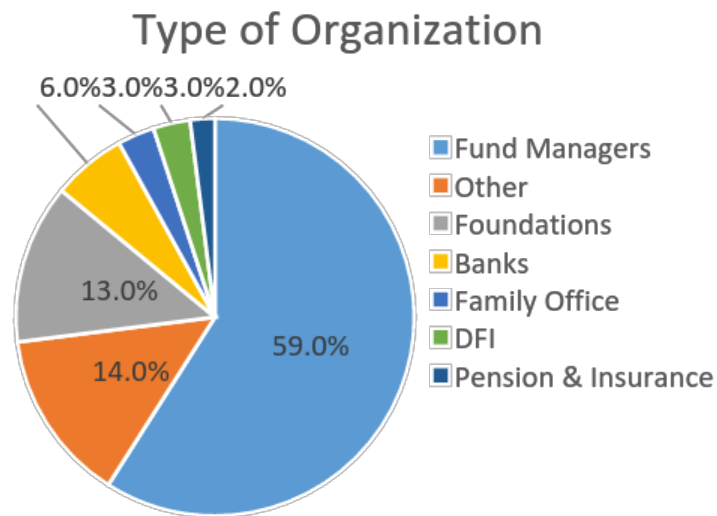
## Areas of focus

- **Profile**
- Types of Funds
- Challenges





## Investors - Profile

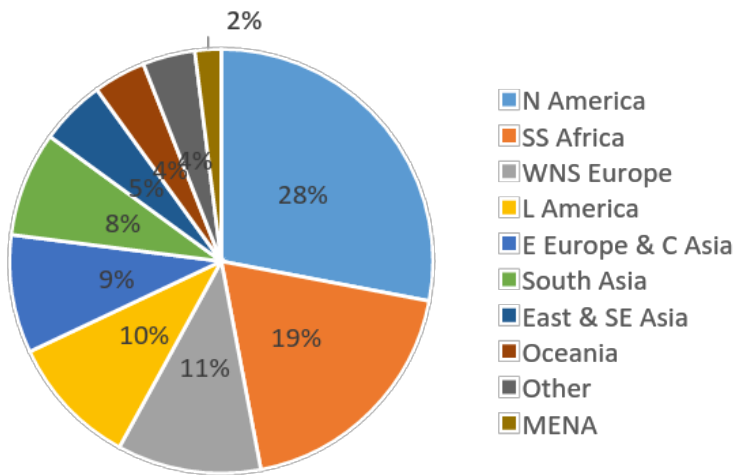


### Asset Allocation

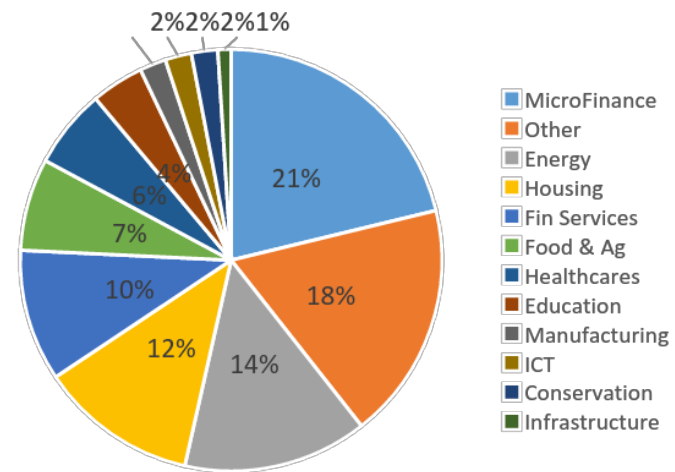
- In 2015, 156 impact investors managed USD 77.4 billion in impact investment assets.
- In 2016, USD 17.7 billion capital was committed to 11,722 deals (with a mean of 75 deals for 113 million and a median of 10 deals for 18 million)

## Investors - Profile

AUM by Geography



AUM by Sector

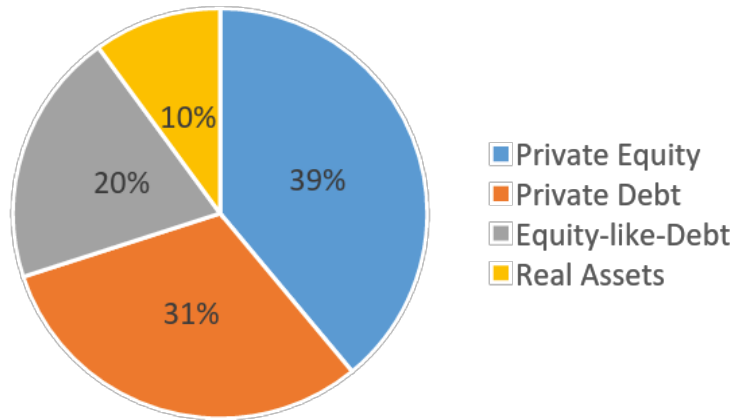


### Capital Flows

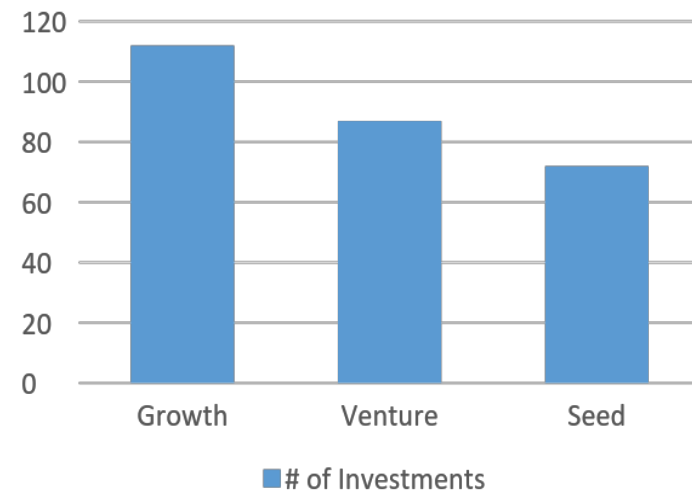
Developed countries, where organizations managing 92% of surveyed AUM are headquartered, control the capital flows to emerging markets, where roughly 50% the assets are allocated.

# Investors - Profile

## Top Assest Classes



## Stage of Business Investments



### Investment Performance

Debt: Average gross return expectations are 5.4% in developed markets and 8.6% in emerging markets.

Equity: Average gross return expectations are 9.5% in developed markets and 15.1% in emerging markets.

## Investors - Profile

### Fund Managers

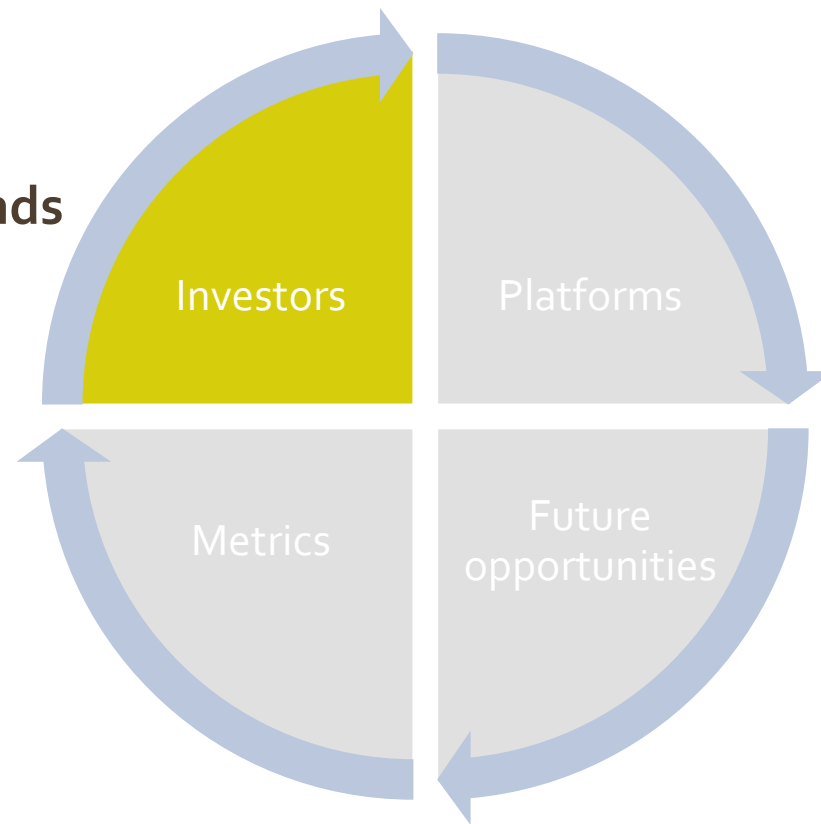
- 66% raise money from family offices/high net worth individuals.
- 61% raise money from foundations
- Banks, Pension Funds, and DFI provide the greatest amount of capital, however only a small number of fund managers are able to raise money from them.

### Top Motivation for Investing

- General Partner's (GP) expertise in:
  - Selecting and managing investments
  - Gaining access to opportunities in specific sectors

## Areas of focus

- Profile
- **Types of Funds**
- Challenges



## Types of Funds

**Fund:** a term used very broadly that includes a variety of pooled funding and investment vehicles.

Investment vehicles used for mobilizing private capital for impact investment in developing countries differ depending on the following criteria:

- Funders objectives
- Risk-return-impact strategy
- Capital and compensation structure
- Financial Instrument used to invest capital (venture equity, growth equity, debt, mezzanine, guarantees)
- Investment strategy and target sector

In the past few years, various innovative funding vehicles have emerged that include significant roles for private capital. Two of the most significant are:

1. Pooled Funds
2. Structured Funds

## Types of funds



### **Pooled funds:**

- Funds those that pool together the capital of many investors and authorize a professional fund manager to invest the funds according to an agreed upon strategy and criteria.
- Pooled funds enable investors to share the risk, reduce transaction costs for themselves and benefit from the professional expertise of the fund manager.



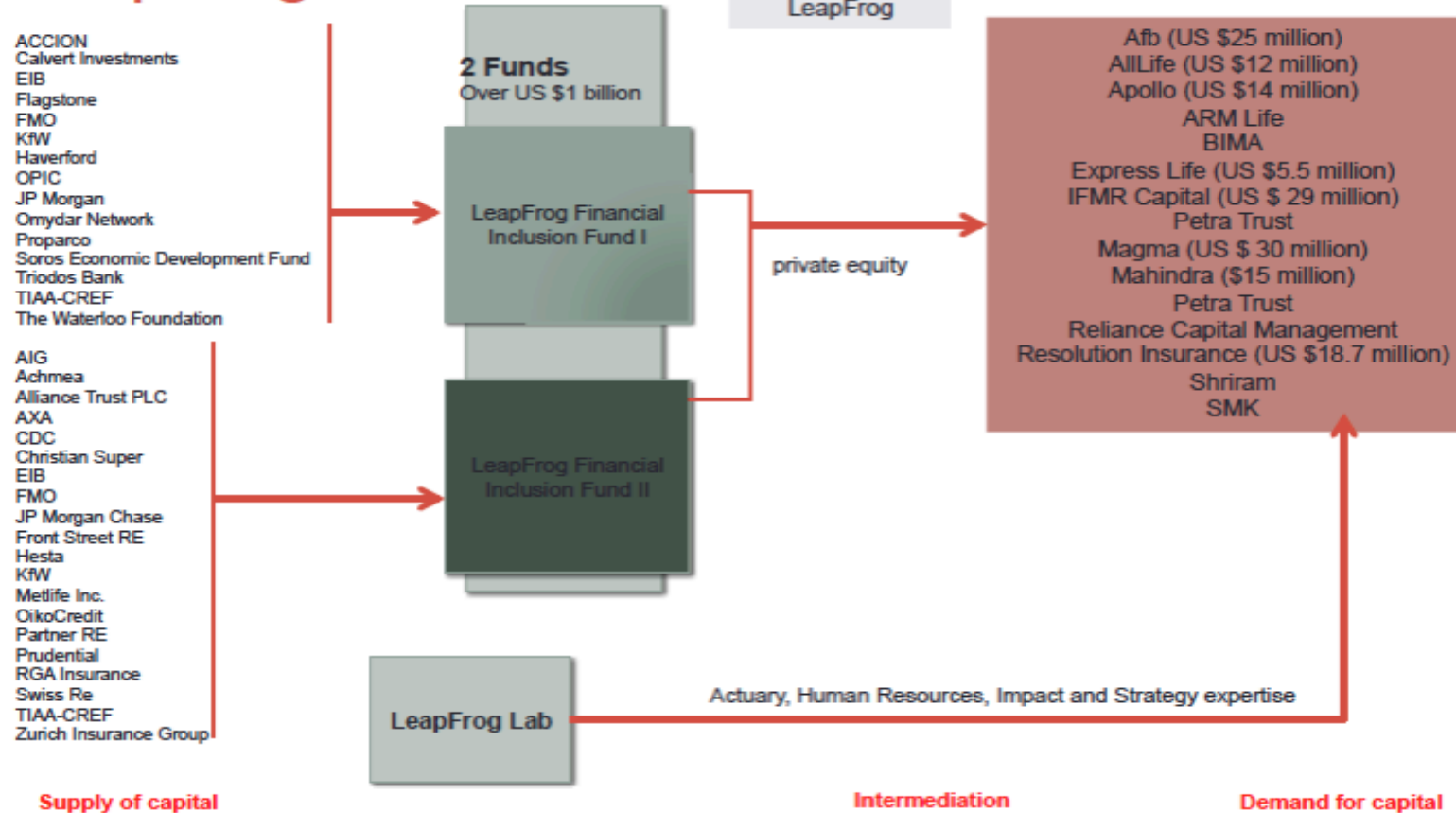
## Example of a Pooled Fund: LeapFrog Investments

<b>Fund Manager</b>	LeapFrog Investments
<b>Lead Investor</b>	LeapFrog Investments
<b>AUM</b>	more than USD 1 billion
<b>Geographic focus</b>	Africa, South Asia and South East Asia
<b>Impact thesis</b>	financial returns and social impact are not mutually exclusive. They invest in businesses that provide insurance and financial tools to low income or excluded individuals.
<b>Investment strategy</b>	high-growth financial services businesses that operate in fast growing markets

<b>Impact measurement</b>	In-house measurement framework FIIRM (Financial, Impact, Innovation and Risk Management), Use IRIS insurance metrics to track both financial and social outcomes
<b>Financial instrument</b>	Private Equity
<b>Investment size</b>	USD 10 million to USD 50 million
<b>Investment period</b>	Four to seven year time horizon
<b>Supporting measures</b>	Provide knowledge and expertise in actuary, human resources, impact, operations and strategy.



# LeapFrog Investments



# Types of funds

## **Structured funds:**

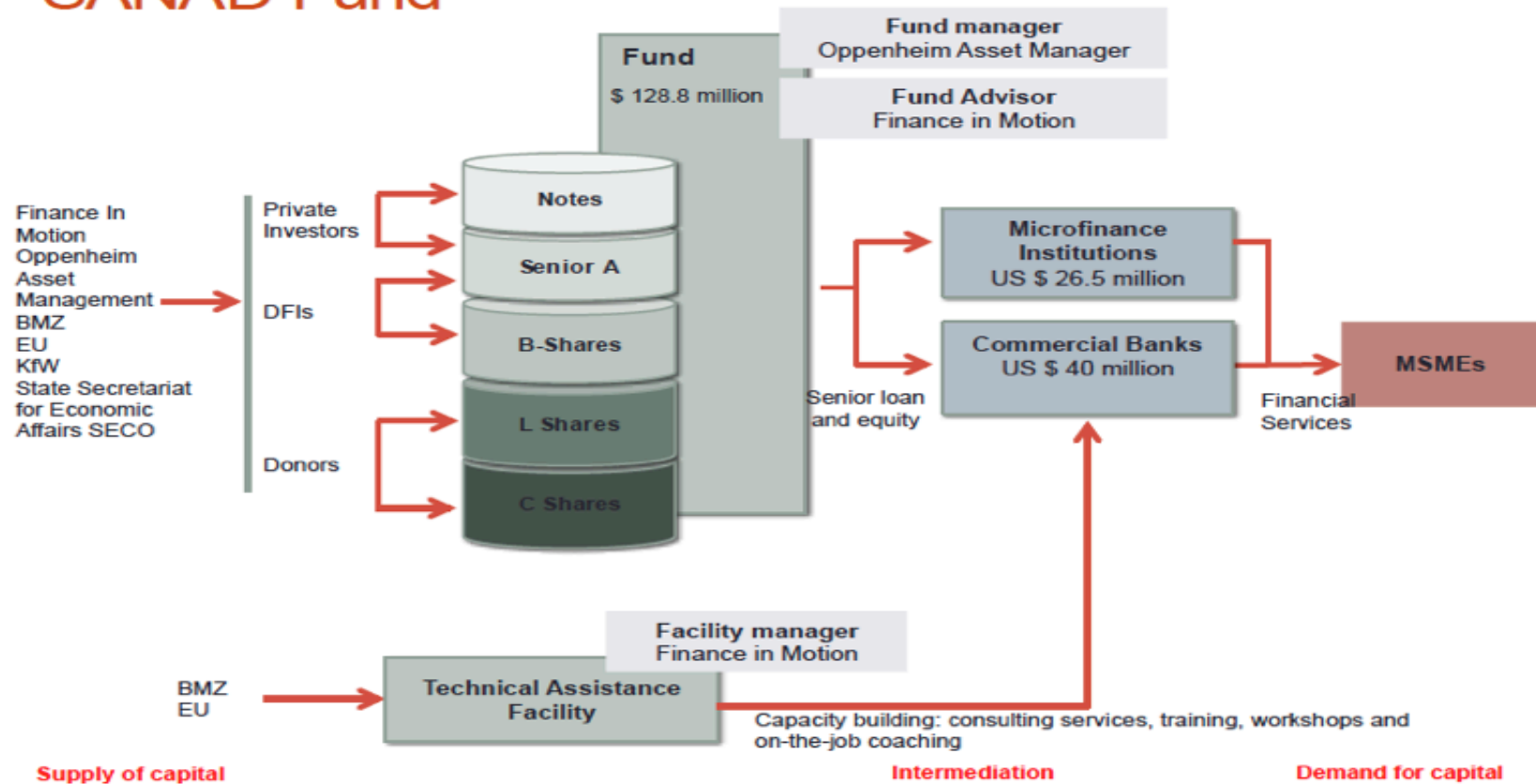
- Funds with a 'waterfall' structure offer opportunities for investors with different risk/return profiles.
- The overall risk is divided into tranches, each with different degrees of 'seniority' (e.g. order of repayment or return allocation in the event of losses, bankruptcy or sale).

## Example of a Structured Fund: SANAD Fund



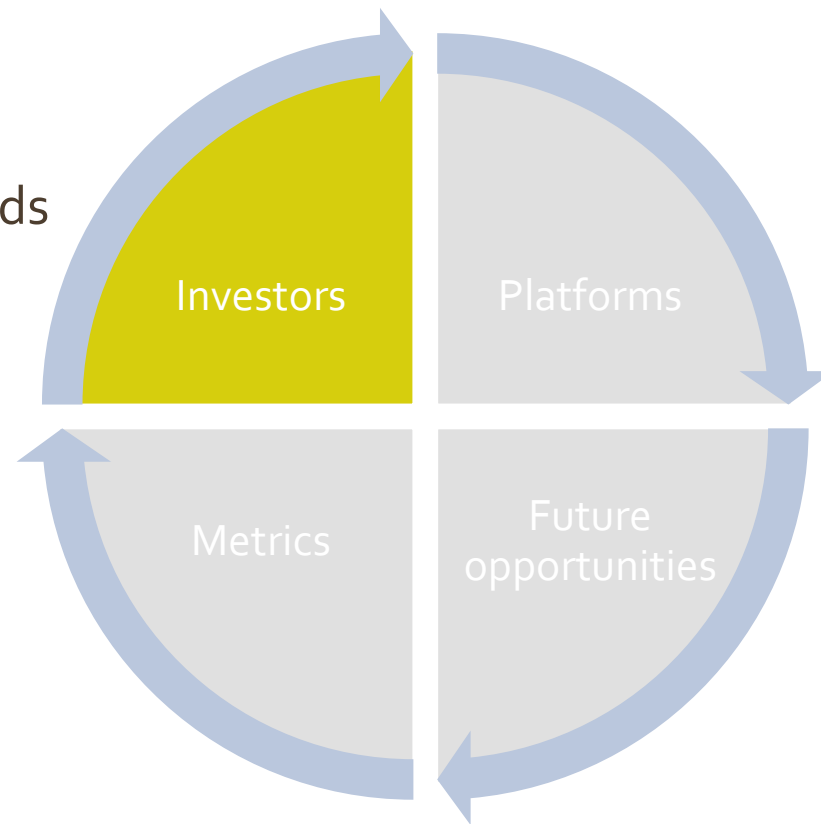
<b>Fund Manager</b>	Oppenheim Asset Management/Finance in Motion	<b>Impact measurement</b>	Impact study every two years
<b>Lead Investor</b>	KfW with investment from BMZ and the EU	<b>Financial instrument</b>	Short, medium and long term senior debt, subordinated loans (including mezzanine loans), term deposits, certificates of deposit, term enhancement instruments, co-investments, stand-by letters of credit, guarantees, equity participation
<b>AUM</b>	more than USD 128.8 million	<b>Investment size</b>	USD 500,000 to USD 20 million
<b>Geographic focus</b>	MENA Region (Algeria, Egypt, Iraq, Jordan, Lebanon, Morocco, Palestinian Territory, Tunisia, Yemen)	<b>Investment period</b>	A shares are issued with maturities of three to ten years, B shares are issued with maturities of five to ten years
<b>Impact thesis</b>	Aimed at job creation, poverty alleviation and financial inclusion in the MENA region by increasing the availability of capital for micro, small and medium sized enterprises (MSMEs). The Fund is particularly interested in creating employment opportunities for youth.	<b>Supporting measures</b>	The Technical Assistance Facility offers capacity building for a partner institution for the purpose of increasing financial services to MSMEs
<b>Investment strategy</b>	Provides debt and equity financing to partner institutions in the MENA region for the purpose of facilitating the flow of capital to MSMEs.		

# SANAD Fund



## Areas of focus

- Profile
- Types of Funds
- **Challenges**



## Top challenges to industry growth

Appropriate Capital Across the Risk - Return Spectrum

High Quality Investment Opportunities (fund or direct) with Track Record

Suitable Exit Options

## Challenge: Appropriate Capital Across the Risk - Return Spectrum

Investors report a shortage of deals that meet various rate of return requirements due to the scale and size of investees:

- Certain institutional investors will only consider deals of a certain size.
- Some sectors, such as microfinance and affordable housing, can meet size and scale requirements, others can only handle smaller direct investments and need innovative/customized financial solutions first before they can scale.

Small in size and requiring customized financing solutions means high transaction costs.

- Investors are not going to get their return back from hitting it big on one investment to cover the cost of the others.
- Investments in social enterprises are not making extraordinary margins boost portfolio performance.

Understandably many investors are turned off by this which leads to market gaps, the difference between the supply of capital, that could be invested in impact, and the availability of investment opportunities that meet the criteria for investment.

Due to gaps, large amounts of capital are sitting on the sidelines while many social enterprises lack sufficient capital. This also leads to lots of capital chasing a few investments.

## Challenge: High Quality Investment Opportunities with Track Record

Most investors seek impact investments that are in the growth or the venture stages. This suggests:

- A low appetite for risk
- A desire for investments with a significant track record and high probability of returns.

Seed and early-stage ventures are a risky propositions for investors because:

- They are inherently risky with long, undefined maturities and high rates of failure, but without the upside of occasional outsized returns which venture capitalists can achieve in other markets.

As a result, entrepreneurs without a track record who start seed or early-stage social enterprises struggle to find start-up capital.

The shortage of “investment-ready” enterprises is one of the major factors preventing more investors from entering the field, and a lack of start-up capital for seed or early-stage social entrepreneurs and opportunities for impact investors is a major barrier for the industry.



## Challenge: Suitable Exit Options

Most investments are private equity or private debt and thus relatively illiquid.

Due to the nature of social enterprises, the most used exit methods are either share buy-backs by the enterprise or the sale of the entire business to a strategic buyer.

Typical exit methods for a venture-backed company in the traditional financial markets is an initial public offering (IPO).

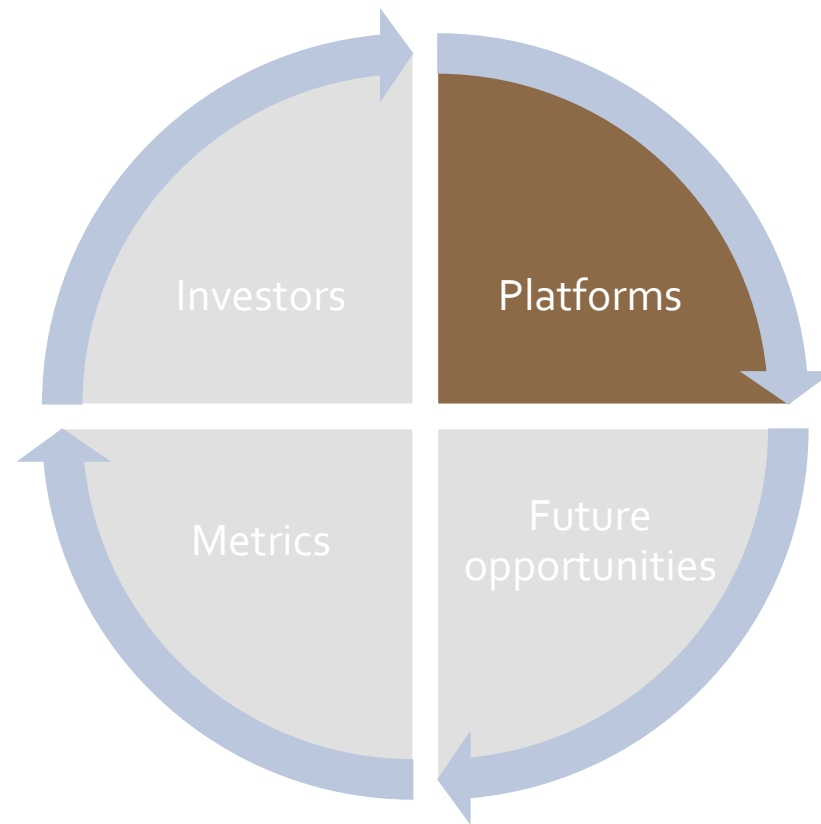
However, this is not an option for most social enterprises because:

1. Immature capital markets in developing and low-income countries.
2. Going public may place shareholders' interests ahead of the impact target.

This is therefore an added source of risk for investors because they cannot easily divest themselves.

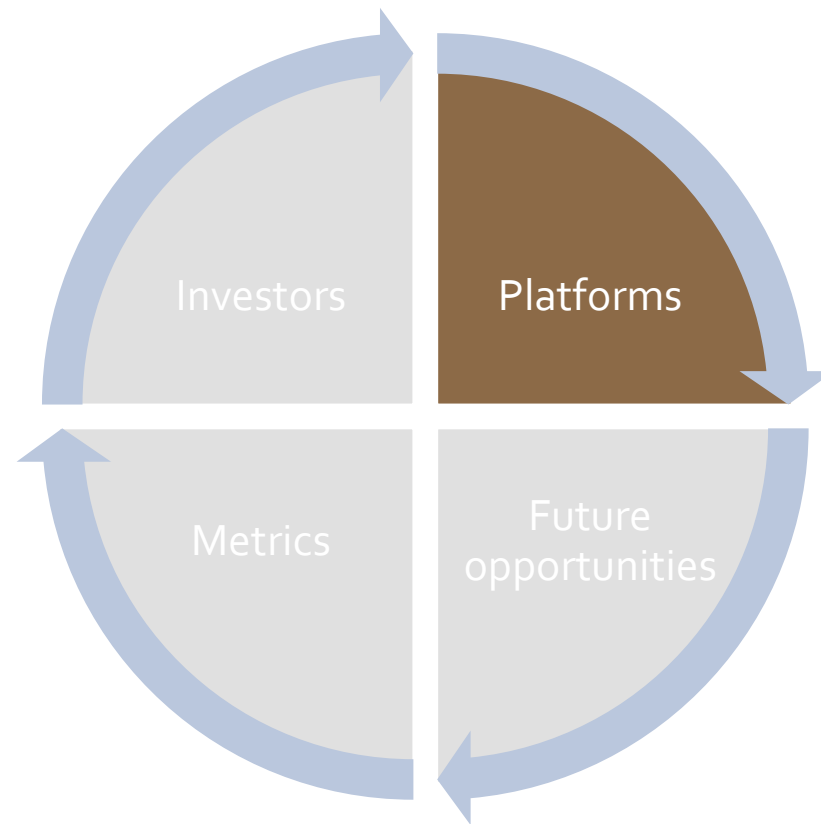
1. Exits can be unclear, leaving impact funds uncertain as to how long they will need to keep companies in their portfolios.

## Areas of focus



- Market Research Findings
- Challenges / Opportunity Gaps

## Areas of focus



- **Market Research Findings**
- Challenges / Opportunity Gaps

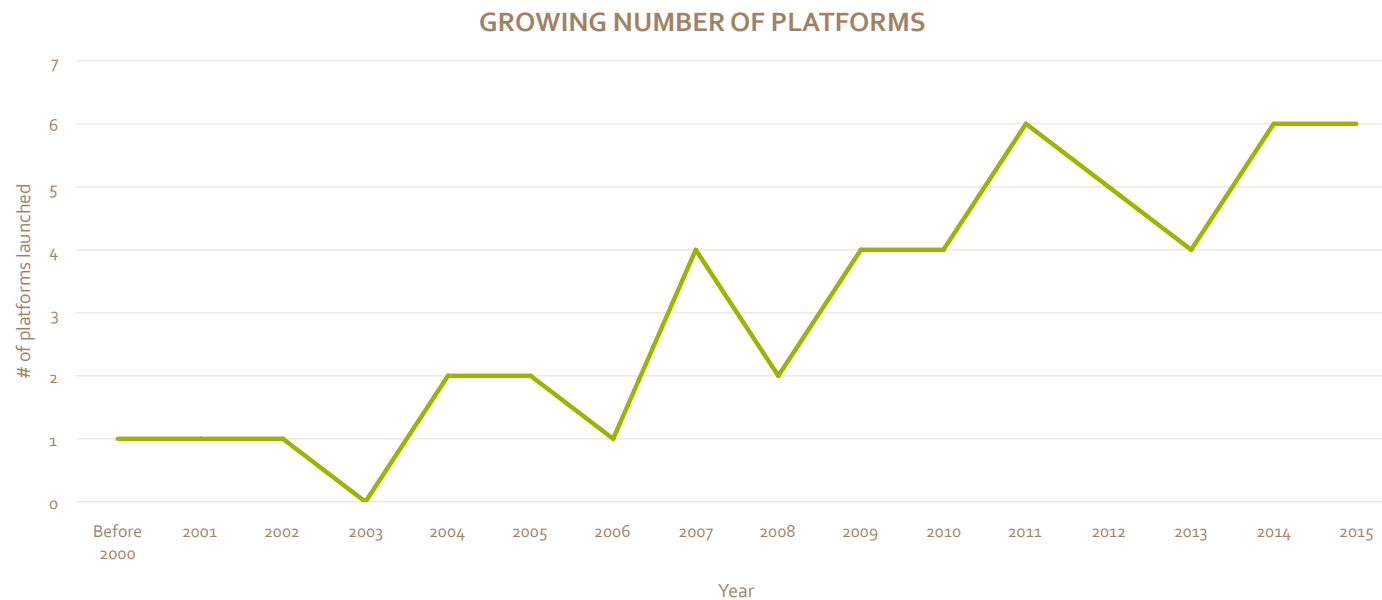
## Platforms

Investment platforms seek to narrow the gap between investors and impact enterprises

- For investors: they address the challenge of finding investable opportunities
- For impact enterprises/funds: they provide opportunities for exposure, support (acceleration or incubation), and access to capital

We conducted a market research study by sampling 67 of the most prominent platforms and initiatives (there are potentially hundreds of platforms)

## General findings

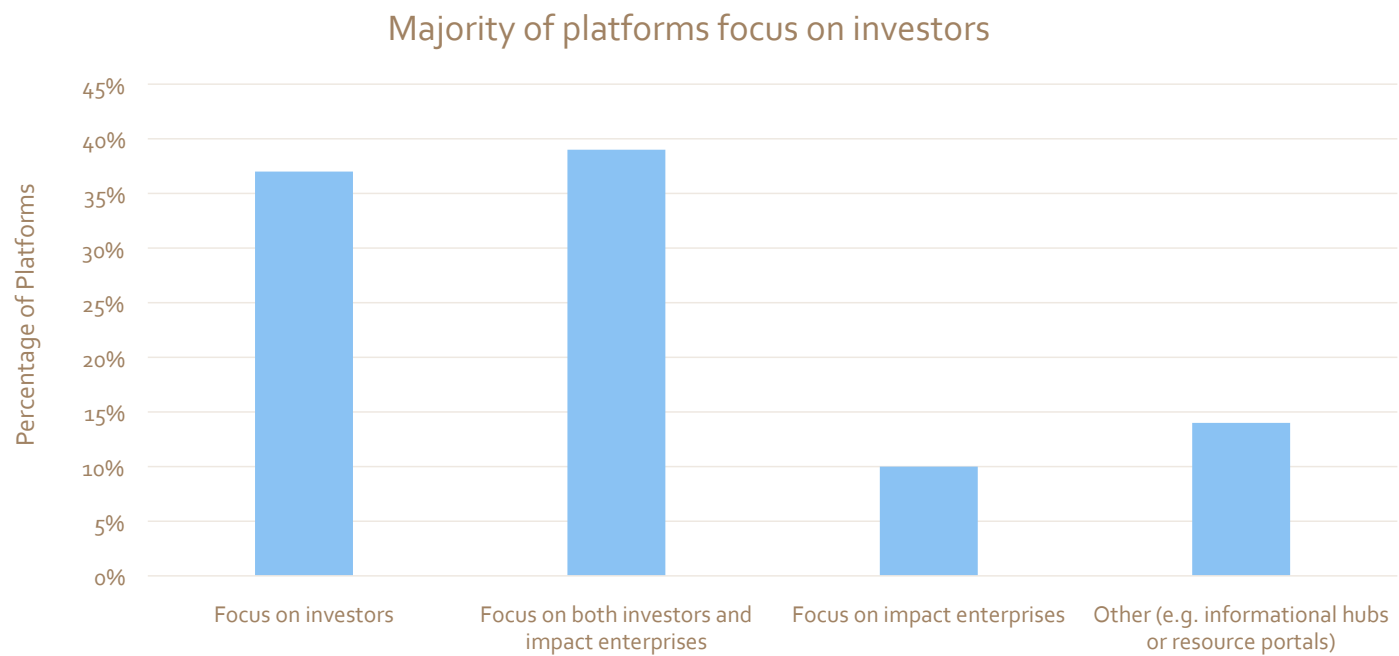


There has been a surge of impact investing platforms in recent years. In our sample, 65% of the platforms were launched or founded after 2010

## General findings

- From our sample, countries leading the way in creating platforms include:
  - United States (27), UK (7), the Netherlands (4), and Switzerland (4) \*
  - \*Note: searches were done in English, yielding mostly English-based platforms.
- Most platforms in our sample did not have a regional focus. Those that did focused on Africa (6)
- Most platforms also did not focus on specific sectors or issues.
  - From those that did, environmental issues including climate change and renewable energy was the most mentioned
  - Sanitation, clean water, agriculture, healthcare, and economic development were also mentioned

## Constituent Focus



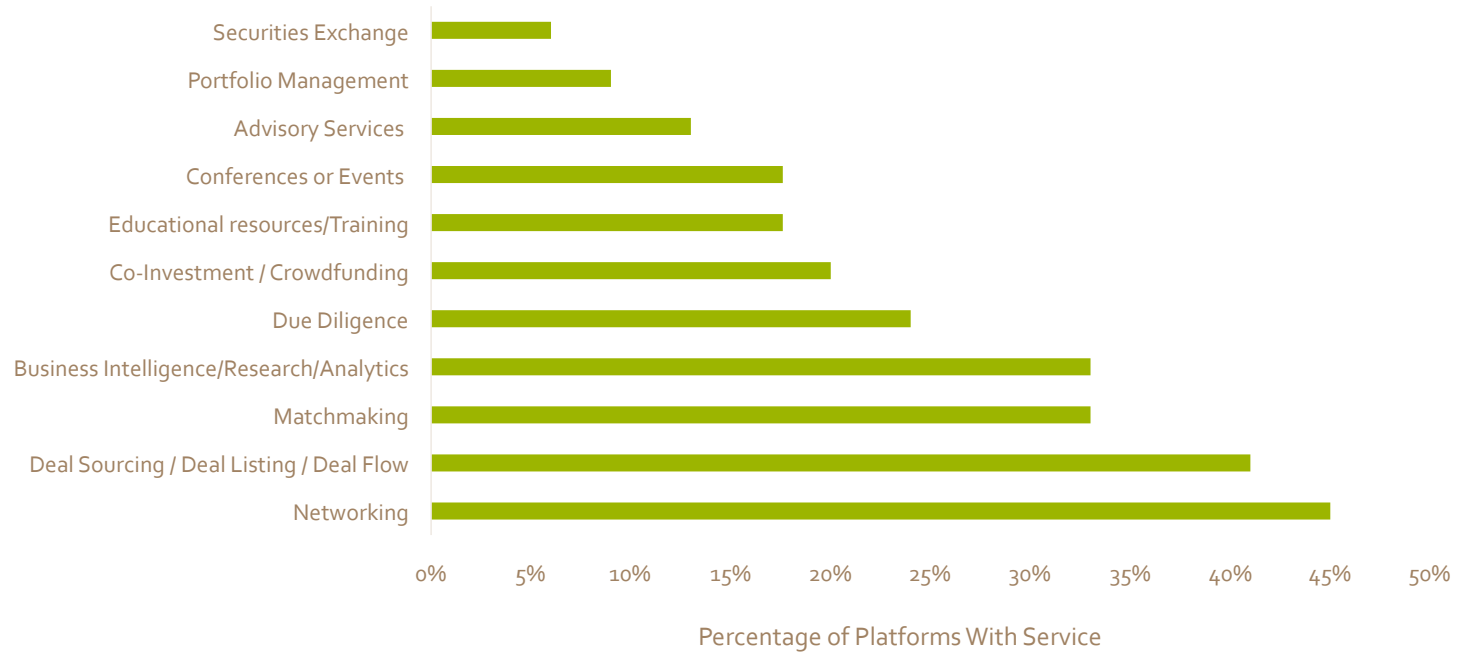
## Services Offered

For Investors	For Impact Enterprises/Funds
<ul style="list-style-type: none"> <li>• Deal sourcing and deal flow (with or without searchable database)</li> <li>• Matchmaking (with or without deal curation)</li> <li>• Due Diligence (spectrum of services from providing data, to provide third party service providers, to offering direct due diligence services)</li> <li>• Networking and resource sharing</li> <li>• Co-investment opportunities</li> <li>• Portfolio management tools and services</li> <li>• Advisory services</li> <li>• Business intelligence</li> <li>• Market research and business analytics</li> <li>• Educational Services</li> <li>• Events/Conferences/Trainings</li> <li>• Securities exchange/broker</li> </ul>	<ul style="list-style-type: none"> <li>• Seed funding/Grants</li> <li>• Crowdfunding</li> <li>• Networking</li> <li>• Support services (advising, mentoring)</li> <li>• Events/Conferences/Trainings</li> <li>• Workspace</li> <li>• Incubator/Accelerator programs</li> <li>• Exposure</li> </ul>

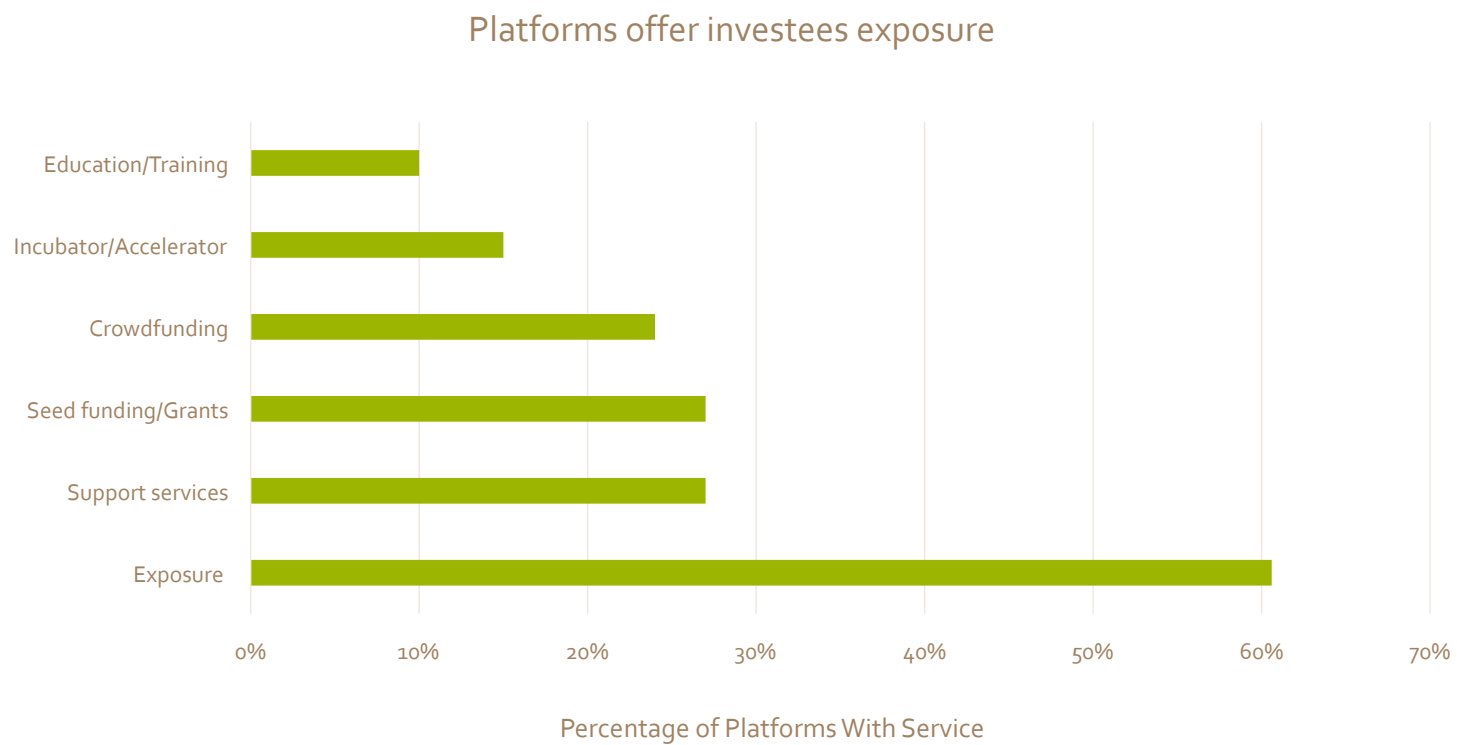


# Investor Services

Networking is the number one service provided to investors



# Investee Services



## Registration/Fee Structures

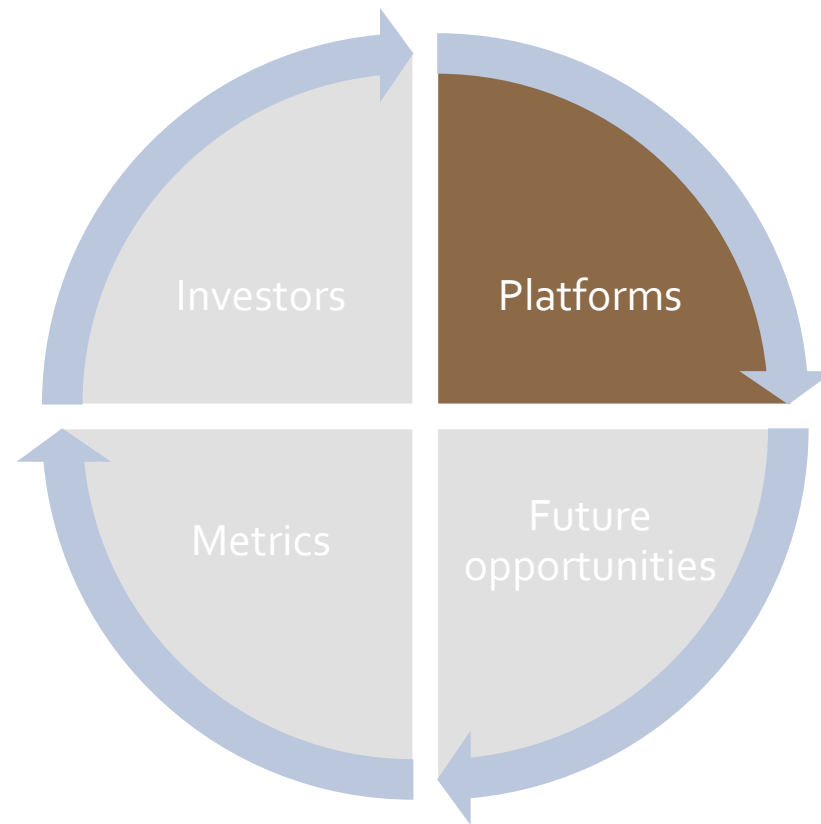
For Investors	For Impact Enterprises/Funds
<ul style="list-style-type: none"><li>• Free registration</li><li>• Invite/Referral only - usually family offices</li><li>• Membership application (with or without annual subscription fee)<ul style="list-style-type: none"><li>• Ranging from \$1000-\$10,000 based on level of services provided</li></ul></li><li>• Service-based fees</li><li>• Investment-based fee (percentage of amount invested)</li></ul>	<ul style="list-style-type: none"><li>• Free registration</li><li>• Application fee</li><li>• Service or project-based fees</li><li>• Investment-based fees (percentage of amount invested)</li></ul>

## Types of Organizations and Funding

- Only 21% (14/67) of the platforms are launched by or as non-profits/NGOs.
- The majority of the platforms are set up as for-profit companies, social enterprises, ventures, incubators or startups.
- Funding for the platforms come from\*:
  - Governmental and intergovernmental agencies (e.g. USAID and OECD)
  - Foundations (e.g. Calvert Foundation, Rockefeller Foundation)
  - Venture Capital Funds (e.g. Pi Investments),
  - Impact Investment Firms (e.g. Omidyar Network, Trillium Asset Management)

*\* Review the appendix for a full list of funders and partners*

## Areas of focus



- Market Research Findings
- **Challenges / Opportunity Gaps**

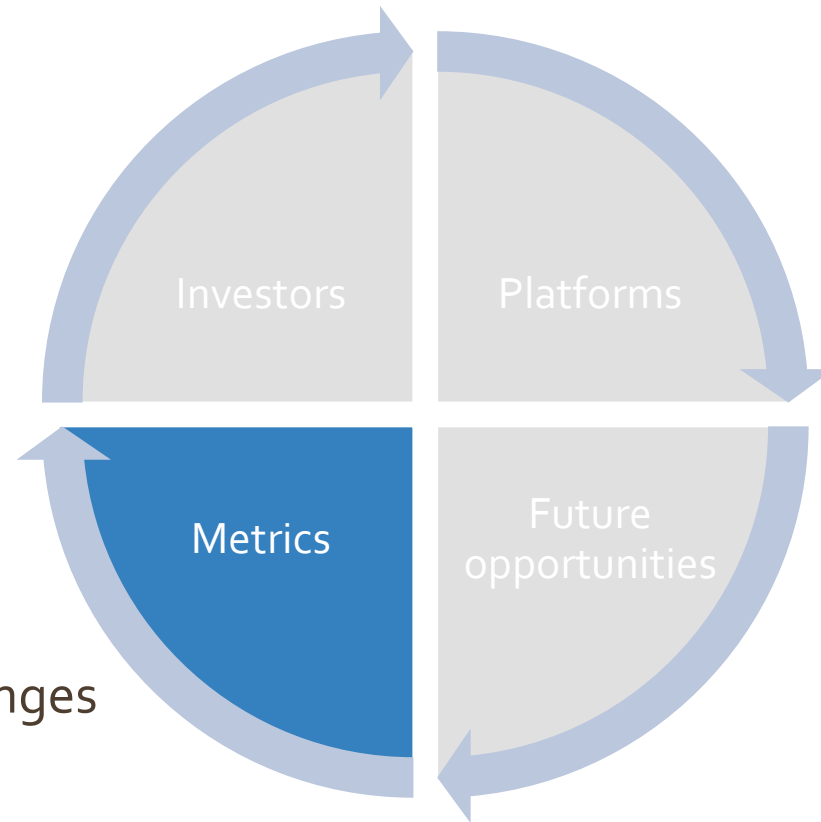
# Challenges

- Limited Deal Flow
  - Deal flow for many platforms is low with only a small number of deals listed
  - Investors are still relying heavily on networking to find co-investment deals
- Scale of investments is too small
  - The scale of deals is too small for most institutional investors and investment funds (these types are deals might do better with crowdfunding or angel investors)
- Lack of due diligence
  - Platforms with larger deal flows don't usually have robust due diligence services
  - Without proper due diligence, investors may be wary of making deals through some of these platforms
  - Due diligence is either borne by:
    - The organization/platform (direct deal curation/portfolio management) – the concern for investors is whether they can trust the platform to accurately vet / select profitable deals
    - The investor – investors have to rely on themselves to do due diligence
      - Documents are provided by the platform, but investors must do their own due diligence
      - Platform provides access to third party service providers to do due diligence
- Imbalance in the focus on investors
  - Most platforms focus primarily on investors with only a small percentage of platforms focusing on providing support services for impact enterprises, dooming many of them to fail

## Opportunity Gaps

- Lack of global tracking of impact/investments
  - There is no platform tracking private sustainable investments like the SDG Philanthropy Platform tracks philanthropy dollars towards the SDGs
  - Proper tracking enables better deployment of funds to necessary regions or SDGs
- Lack of a single resource for private impact investments
  - Global Innovation Exchange aggregates thousands of innovations and funding sources into a comprehensive searchable database
  - Gust's large database of startup and investors allows for quick and easy matchmaking
  - However, both platforms do not specifically focus on impact investments
  - Aggregating all impact investments in one site will:
    - Provide exposure to smaller platforms with only one or two deals
    - Have a critical mass of deals
    - Create a one-stop resource for investors and investees

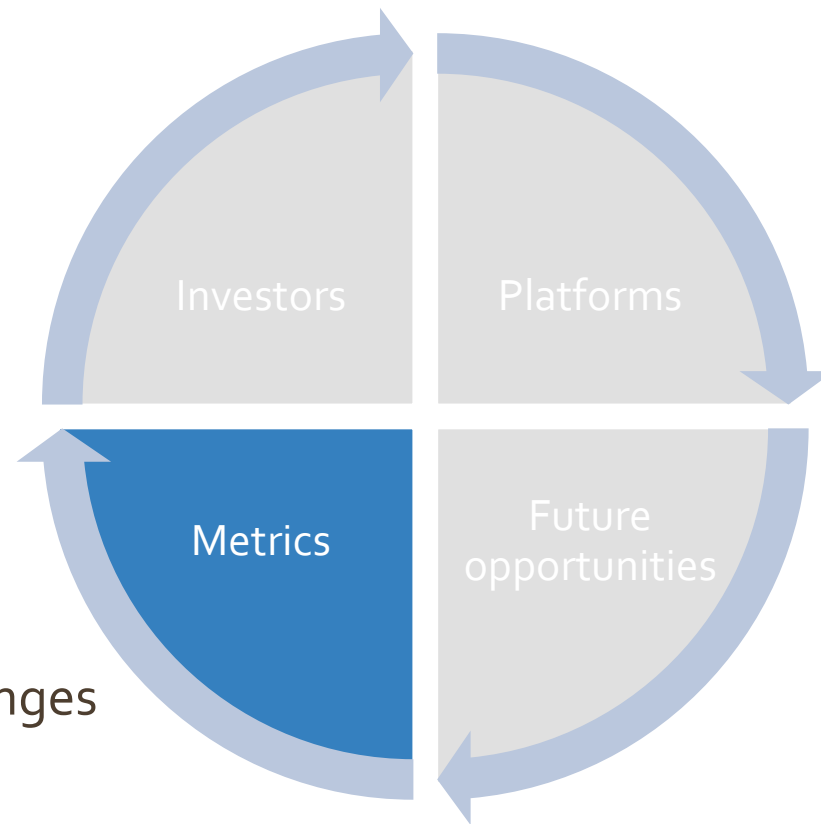
## Areas of focus



- Intro
- Examples
- Barriers /Challenges



## Areas of focus



- **Intro**
- Examples
- Barriers /Challenges

## Metrics – Why they matter?



- There is broad consensus that to transition from philanthropic exercise to legitimate instrument of global change, impact investing must develop universal standards of measurement
- Effectual social impact measurement is critical to five key market participants: government, foundations, social sector organizations, impact-driven businesses and impact investors
- The growth of the sector is hampered by informal, variable, and faulty methods of data collection (Emerson, Jed and Williams, Sarah. p.57)
- Its prospects for affecting change will be constrained without universal standardization
- There is no agreement on how best to assess something less quantifiable than a financial return
- Several decades into the development of Impact Investing, the central question remains, **“How does the impact investment field establish evidence about its contribution to positive social and environmental impacts?”** (Reisman, Jane, and Olazabal, Veronica)

## Parallels between Social & Private Sector Investment Evaluation

Social Sector	Private Sector
<p><b>Why evaluate?</b></p> <ul style="list-style-type: none"><li>• Transparency &amp; accountability</li><li>• To understand and improve the impact of interventions</li></ul> <p><b>What is measured?</b></p> <ul style="list-style-type: none"><li>• Changes in lives, practices, policies, systems, and conditions</li></ul>	<p><b>Why evaluate?</b></p> <ul style="list-style-type: none"><li>• To make data-driven decisions</li><li>• To support profit generation</li></ul> <p><b>What is measured?</b></p> <ul style="list-style-type: none"><li>• Primarily changes in revenue and profits</li><li>• Outputs and activities such as services delivered and people reached</li></ul>
<p>While the market solutions for achieving social and environmental impact are growing, measurement practices that assess impact to create an evidence base are not keeping up with this growth.</p>	

(Reisman and Olazabal, p. 4)

## Key Questions



Fundamental questions remain unanswered:

- How to quantify what is less concrete than a financial return?
- How to gauge risk in unfamiliar circumstances?
- How to improve understanding of how outputs (i.e. meals served, plastic bottles conserved, etc.) are consistently translated into outcomes (i.e. health, sustainability, etc.)?
- How can 'impact returns' across different fund categories be compared against one another?
  - For example: can 'poverty alleviation' and 'increased sustainability' be measured against one another by a universal system of value assessment? (Smaling, Lindsay and Emerson, Jed., p. 7)

## Key Concerns

- The quantification of social and environmental impact is very involved; to date, it has been largely conducted by experts
- Wide-scale adoption will be necessary to establish accepted reporting and performance standards
- Simultaneously, there is concern among social scientists that standardized measurements risk the neglect or fabrication of key elements of social change (*Brandenburg, Margot. p. 48*)
- Any accepted system of measurement must not create unrealistic amounts of data collection for the organizations expected to implement them, so the right balance needs to be reached, requiring considerable collaboration between measurement experts and partner organizations/ social enterprises ("Impact Investment: The Invisible Heart of Markets" p.32)
- If impact measurement does not achieve an industry-wide level of rigor and standardization, the label "impact investing" risks becoming insignificant and used solely as a marketing tool for commercial investors (So, Ivy, and Alina S. Capanyola)

Sources: Brandenburg, Margot. "Making the case for social metrics and impact investing." *Community Development Investment Review*. P. 47. <http://www.frbsf.org/community-development/files/Brandenburg.pdf>

"Impact Investment: The Invisible Heart of Markets." *Social Impact Investment Taskforce* (n.d.): n. pag. 15 Sept. 2014. Web. 3 Feb. 2017.

So, Ivy, and Alina S. Capanyola. "How Impact Investors Actually Measure Impact (SSIR)." *Stanford Social Innovation Review*. N.p., 16 May 2016. Web. 16 Apr. 2017. [https://ssir.org/articles/entry/how\\_impact\\_investors\\_actually\\_measure\\_impact](https://ssir.org/articles/entry/how_impact_investors_actually_measure_impact)

## Barriers to Impact Measurement

CATEGORY	DESCRIPTION
Defining positive impact	Diverse stakeholders hold diverse definitions of positive impact; some definitions may be competing or conflicting.
Examining complexity of impact measurement	Impact is multidimensional, making standardization of measurement a challenge.
Recognizing mismatch of methods with early-stage business models	Early-stage business models may not lend themselves to measurement, while the fluid and evolving nature of enterprise may necessitate the adoption of numerous and different business models throughout the lifetime of the enterprise.
Perceived value vis-a-vis alignment with investor priorities	Incentives for impact measurement can sometimes be unclear. The value of impact measurement is not consistently understood, including how it can support operations.
Navigating how impact investing fits into the larger landscape	Investors struggle to see how their vision for impact might align with larger existing efforts, such as SDG measures. Current measurement systems exclude B corporations and corporate social responsibility writ large and other classes of companies.
Facing lack of specificity about intentionality	Investors struggle with intentionality of their impact goals, resulting in a weak link between goals and what is measured.
Articulating the value proposition	The value of impact measurement has not yet been clearly articulated and communicated.

(Reisman and Olazabal, p. 9)

## The case for standardization

Standardized measurement will:

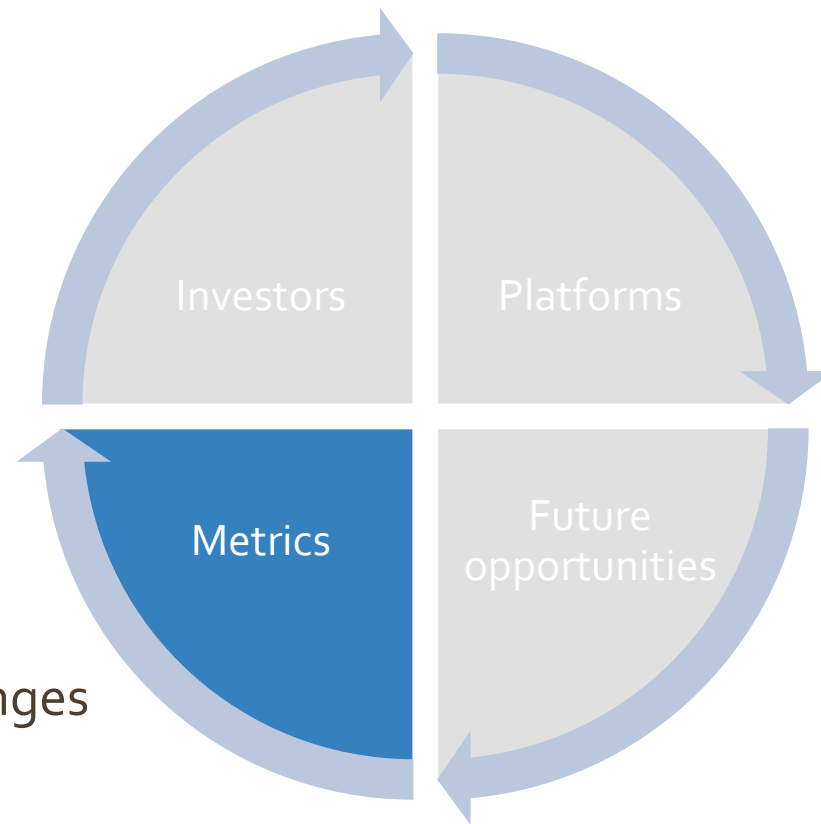
- Benchmark progress
- Create an effective market, and allow for its growth
- Promote the flow of capital
- Provide tools for determining the success of investment vehicles
- Maintain accountability for intended recipients
- Help organizations make better decisions and communicate value with certainty

## The cycle of data collection and impact evaluation





## Areas of focus



- Intro
- **Examples**
- Barriers /Challenges

## Competing Measurement Systems

- Over 550 metrics systems exist as catalogued by IRIS, the catalog of generally accepted performance metrics ("IRIS Metrics.")
- These systems evaluate the social, environmental, and financial performance of an investment
- The following systems/aggregators have broad market saturation, but are by no means predominant:
  - IRIS
  - B Analytics
  - GIIRS

# IRIS



- Housed within the Global Impact Investing Network (GIIN)
- The Impact Reporting and Investment Standards (IRIS) maintain a set of standardized reporting metrics to chronicle social and environmental performance and provide common measurement and statement of impact across portfolios
- The IRIS initiative functions as a directory of collected IRIS-compliant data that allows for standardized reporting and allows for the comparison of data across funds, companies, investment portfolios and other organizations
- The IRIS assimilates sector-specific best practices, incorporates user and expert feedback, is updated regularly, and reports on major trends across the impact investing industry

## B Analytics



- An adaptable platform for evaluating, benchmarking and briefing on impact
- B Analytics enables investors to:
  - Search a database of ratings information for over 1000 companies and 70 funds
  - Access aggregate performance data on all funds in the system
  - Use to B Impact Assessment, Iris Catalog metrics, or custom metrics to measure and evaluate the performance of portfolios
  - “Benchmark and report on the impact of their portfolio based on either ratings information or responses to individual metrics” (“B Analytics”)
- IRIS and B Analytics are complementary and operate in the impact investing space in roles that are analogous to those played by institutions in the traditional investing space

## GIIRS

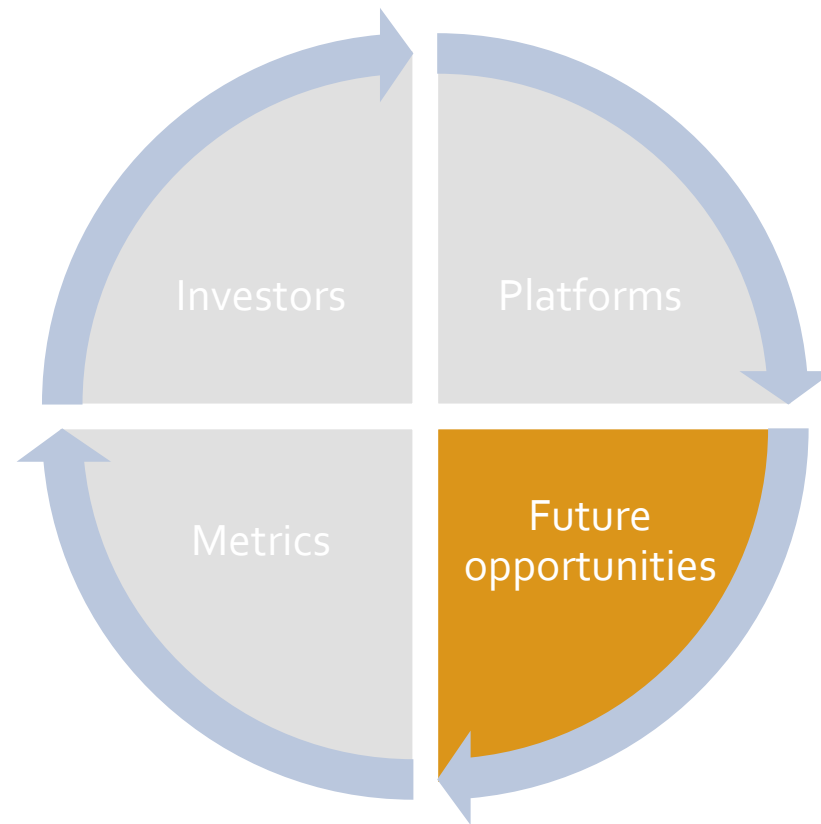


- Managed by B Lab
- A comprehensive rating of social and environmental performance; Financial performance is not evaluated
- Used to access a third-party evaluation about a fund or company's performance
- Reports on impact performance of a fund, company, or portfolio
- Identifies areas where companies or funds can improve their social or environmental performances
- GIIRS provides more detailed information than provided in a [B Corp](#) score.

## Alternative methods

- **Expected Return Methods** assess the expected benefits of an investment against its costs; social return on investment (SROI), in particular, offers a framework to evaluate an investment's present social value of impact compared to the value of inputs
  - Users: grants-based organizations, and some impact investors
- **Theory of Change Methods** map out the intended process for achieving social impact, often with a logic model, which outlines the connections between input, activities, output, outcomes, and ultimately, impact
  - Users: Acumen and LGT Venture Philanthropy
- **Mission Alignment Methods** evaluate the realization of strategy against a project's mission and ultimate goals over time, utilizing measures to monitor and manage key performance metrics on operational performance, organizational effectiveness, finances, and social value
  - Users: Bridges Ventures
- **Experimental and Quasi-experimental Methods** are after-the-fact measurement tools that use randomized control trials or other counterfactual approaches to establish the impact of an intervention compared to the situation if the intervention had not taken place
  - Users: Social Impact Bonds

## Areas of focus



## Future Opportunities

To encourage more investment in impact investing:

- Support from governments to impact investors and social enterprises could encourage more capital across the risk/return spectrum. Examples are:
  1. Implementing tax credits and subsidies
  2. Offer technical assistance to both the impact enterprises and investors to help mitigate business risks
- The creation of secondary markets and publicly tradable securities should be promoted to alleviate the current lack of exit options for investors.



## Future Opportunities

- Further market research through focus groups and surveys to hone in on desired platform features for investors and investees
- Develop gamification elements on platforms to encourage greater impact investment
- Encourage more incubation, acceleration, and support for impact enterprises – investments can only take place with a thriving pool of impact enterprises
- Partner with intergovernmental agencies and foundations to develop a private impact investment tracker or aggregator

## Future Opportunities

- Conceive of new measurement practices that borrow from business metrics and social sector evaluation
- Devise consistent metrics to apply to every investment, even if additional evaluation must be conducted for ancillary results
- Invest in studies that establish a link between social and environmental metrics and financial performance
- Build market infrastructure – beyond the scope of what currently exists - to support the sharing of knowledge and facilitate evaluation
- Encourage intergovernmental collaboration to develop and adopt one set of accepted standardized metrics (similar to generally accepted accounting principles)