Impact investments: impact and profit for everyone?

by Andreas M. Rickert, Chairman of the Board of the non-profit analysis and consulting organisation PHINEO gAG

Though it may sound contradictory, it isn't actually: more and more investors are using their capital to create benefits for society. The young – and still relatively small – market segment of impact investing is growing continually and can be seen as the avant-garde of a sustainable finance system.

At the age of 14, Dirk Müller-Remus's son is diagnosed with Asperger's, a mild form of autism. Dirk learns about the syndrome, attends a self-help group on the topic of autism and work, and learns that many adults with Asperger's are out of work in spite of being well educated – in Germany, more than 85 per cent of them. So autism is a shortcoming? Dirk decides he intends to change this point of view.

More than ten years have passed since then. Today, the IT service company Auticon, which Dirk, 61, co-founded in 2011 on the basis of his experiences, employs more than 150 people on the autism spectrum in Germany, France, the UK and the USA, and places them with renowned clients such as Allianz, CNBC and Fox News to work on projects. The idea behind the company is that people with autism often have special gifts in the areas of logic, attention to detail and pattern recognition – skills that are especially important in the fields of IT and data analytics. And surprisingly, Auticon's clients have come to appreciate another of the IT specialists' traits over the years – the company now even advertises their "absolute honesty" on its website. Auticon's success goes to show that financial returns and a social impact do not have to be mutually exclusive.

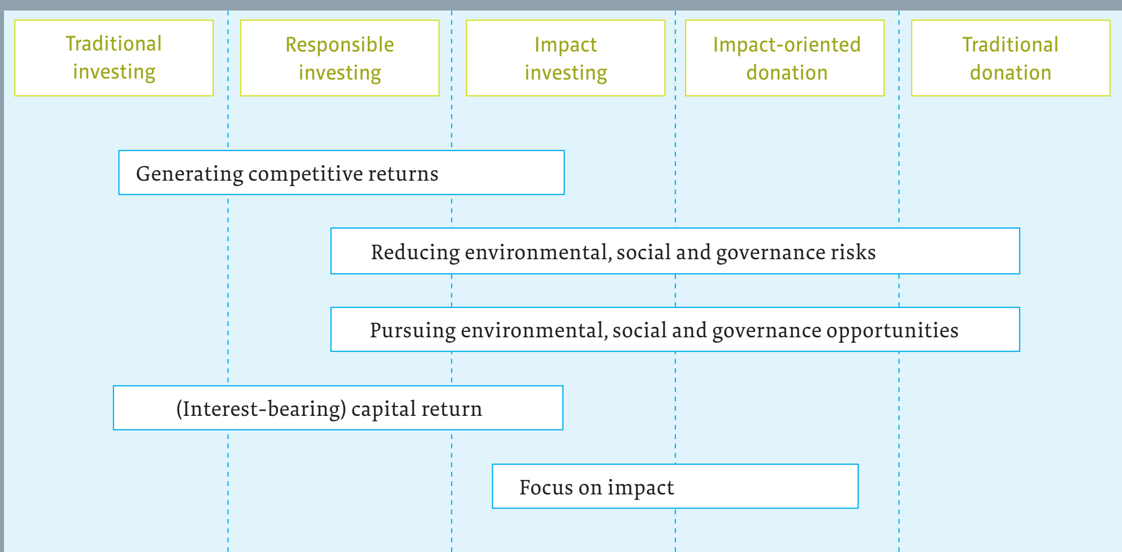
Doing good while also generating a profit – this form of investment is known as impact investing. "Impact investing is about using private investment capital to tackle a social issue in a way which is very direct, intended and quantifiable, and which delivers at least capital preservation or indeed a financial return," says Brigitte Mohn, member of the Executive Board of the Bertelsmann Stiftung, which is active in the field of impact investing. "For me, the crucial points are the very explicit intention and an obligation to measure the social impact had."

It is in this way that the relatively new market of impact investing sets itself apart from conventional investment that primarily serves to generate a profit. It is also distinctive from the broader field of sustainable investment as there is a much greater focus on the effect that an impact investment has. In contrast, people who make a conventional donation are not pursuing financial interests, and are rather seeking to effect societal change with their contribution.

"We're going through a period of experimentation and proof of concept in impact investment today," says Sir Ronald Cohen, the British businessman who has been dubbed the "father of venture capital" and the "father of social investment". "I have no doubt that we will be successful, just as I had no doubt that we would be successful in venture capital." Cohen believes "it's a question of inspiring the millennial generation to do again what it did in the tech revolution: But this time, to do it for impact – doing good and doing well at the same time."

Impact investments can do their bit all over the world – they can be made both in developed and in newly industrialised and developing countries. What matters is that they serve to tackle global challenges, with capital being invested in, for example, businesses in the areas of sustainable agriculture, renewable energies, healthcare, education, financial inclusion or social and ecological housing construction. Most asset classes now offer the option of impact investing. In addition to publicly traded forms such as shares, bonds and investment funds, there are special

INVESTMENT SPECTRUM



investment forms such as guarantees and hybrid forms of financing. Impact investors usually make a direct private investment in a company by providing either equity or debt capital. The amount of returns expected varies according to the impact strategy, the investment sector – for example, education or healthcare – and the financial instrument, such as a loan or equity.

Financial returns and a social impact: not mutually exclusive

Impact investments currently account for only a fraction of the global investment funds, but both the interest shown in this new form of investment and the volume of such investments are increasing from year to year: the Annual Impact Investor Survey prepared by the Global Impact Investing Network (GIIN) puts the figure for 2018 at 228 billion dollars. This equates to approximately 194 billion euros. According to the FNG's market report, the volume of impact investing in Germany in 2017 was 5.2 billion euros. For comparison, the market for sustainable investments in Germany is worth 171 billion euros. Just a small proportion of this remains in Germany, while the lion's share goes to developing and newly industrialised countries in the form of microfinance.

There is room for improvement here – but impact investments are indeed gaining in importance, with demand for them increasing from both private and institutional investors. The authors of the GIIN study write: "Of all the respondents to the survey, over 50 per cent made their first impact investment in the past decade, indicative of the ongoing entry of new players to the industry." In Germany, the recently founded Bundesinitiative Impact Investing is helping to forge links between German market players. It was initiated jointly by the Bertelsmann Stiftung, the BMW Foundation, the Association of German Foundations and PHINEO and has its roots in Germany's National Advisory Board within the international Social Impact Investing Taskforce established by the G7 member states.

Just how strongly this market segment will continue to grow also depends on successful impact measurement. Impact investment has its effect by successfully implementing and scaling up an impact-oriented business model, in other words growing as a company while also generating increasing profit. In the case of an impact investment, the social impact is an integral part of the business model, with economic success and impact going hand in hand. However, if the social impact of an investment is just as important for people's decisions to invest as the risks and the return expectations, it is essential that this impact be defined and measured, and that the investors are given transparent information on this. Investors therefore examine the impact potential of the companies set to receive their capital during the due diligence process – i.e. the careful assessment of risk – that precedes their investment decision. They also assist the companies in realising this potential during the term of their investment and beyond – at least in cases where the investors assume an active management role.

Support for the Sustainable Development Goals

One of the effects of an impact investment can be that it contributes to the 17 global Sustainable Development Goals (SDGs) agreed upon by the United Nations in March 2015 and to be achieved by 2030. For example, impact investors might invest growth capital directly in a so-called impact venture which seeks to realise one or more of the SDGs. Various impact investment funds likewise align their investment strategies with the SDGs and specifically seek out investments that contribute to particular Sustainable Development Goals such as combating poverty and improving education. In this instance, too, investors develop impact indicators that they derive from the SDGs to make an investment's contribution to the Sustainable Development Goals visible and quantifiable. For example, in 2011 the KfW bank initiated the creation of the SANAD fund with the aim of financing micro-entrepreneurship, SMEs, and financial inclusion and integration in the labour market in the MENA region – and thus combating poverty. This fund is unusual in that it covers the entire spectrum of financial players, from microfinance institutions and commercial banks, to leasing and factoring companies, financial service providers and other financial institutions. One of the many projects supported by the SANAD fund is Vitas Jordan. This Jordanian microfinance institution has been lent three million US dollars, enabling it to pay out an additional approximately 2,200 loans to small companies and micro-enterprises. In turn, these businesses create income, jobs and prosperity for their families and the local communities. The National Bank of Egypt has likewise borrowed money – 7.5 million US dollars – from the SANAD fund, allowing it to offer loans to more micro-businesses and SMEs. The fund currently manages assets totalling 298.4 million US dollars and comprises both public and private investments.

Promoting innovations and solutions within society

Impact investments help entrepreneurs to develop and scale up business-minded solutions to social, societal and environmental challenges. In many areas, private investment capital unlocks new creative potential that boosts progress within society and gives effective approaches a reliable financial basis, such as when impact start-ups develop products and services that meet a previously unmet societal or social need and are of benefit in particular to people whose participation in society is limited due to their being disadvantaged educationally, economically or with regard to their health. In other instances, impact-oriented businesses directly integrate specific target groups into the value chain in a fair and sustainable way, thus helping them to get on their feet financially – companies such as Auticon or discovering hands, a non-profit enterprise that integrates blind and visually impaired women into the labour market. It also plays an important part in early cancer detection – the company says it is scientifically proven that the women it trains as "medical tactile examiners" (MTEs) can detect around 30 per cent more tissue alterations than doctors in physical breast examinations. Considering 70,000 women a year develop breast cancer in Germany, the potential of this social business idea, which won the 2016 Next Economy Award, the sustainability award for start-ups, is evident.

Impact investments can also help to make the rapid progress in areas such as digitalisation, artificial intelligence and biotechnology have a social and environmental impact and be of benefit to especially neglected target groups. It was with this objective that PHINEO created the Tech4Impact Fund. The fund seeks to promote responsible entrepreneurship within the technology sector by investing in innovative tech start-ups that tackle a societal need.

Social impact bonds (SIBs) are a special case within the impact investment market. This form of financing, which has so far been implemented in 109 pilot projects around the world, is a partnership between the public sector, social funders and a service provider that implements the measures. The idea is to try out new forms of social intervention that would otherwise not have access to any resources because their development and introduction costs are so high. But with an SIB, the public sector as the customer reimburses the funders with their capital plus an agreed risk compensation based on the degree to which the project achieves its impact targets within a specified time frame. There are currently two SIBs running in Germany, both developed and implemented by the Bertelsmann Stiftung together with PHINEO and local partners. One of them enables the city of Mannheim to give two primary school classes special assistance for their first four years, in particular helping children from non-German-speaking families based on their needs with the aim of offering all schoolchildren the same education opportunities.

Like impact investments in general, SIBs are not in competition with the state-financed social systems. Rather, they can make an important contribution to promoting social innovations for which there is often little scope for development within the rigid welfare state structures. Much like the SIB model, there are also so-called development impact bonds (DIBs) in the development policy context, the difference being that the role of the customer is usually assumed by an international donor rather than the local government.

The avant-garde of a sustainable finance system?

There is growing awareness within the finance sector that all companies have a societal, social and environmental impact – impact that is either positive or negative. A sustainable finance system can only be established in the medium to long term if the financial markets price these effects into their evaluations and take the social and environmental impacts into account in their investment decisions as much as they consider the risks and returns. Initiatives such as the Hub for Sustainable Finance play an important part in promoting this change in awareness in the mainstream. As such, based on their strong impact focus, impact investments can be considered the avant-garde of a sustainable finance system.

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