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Impact investing for diversification

By

Investments for economic diversification: Environmental, social and governance-related transparent reporting

The views expressed are those of the author and do not necessarily reflect the views of UNCTAD.



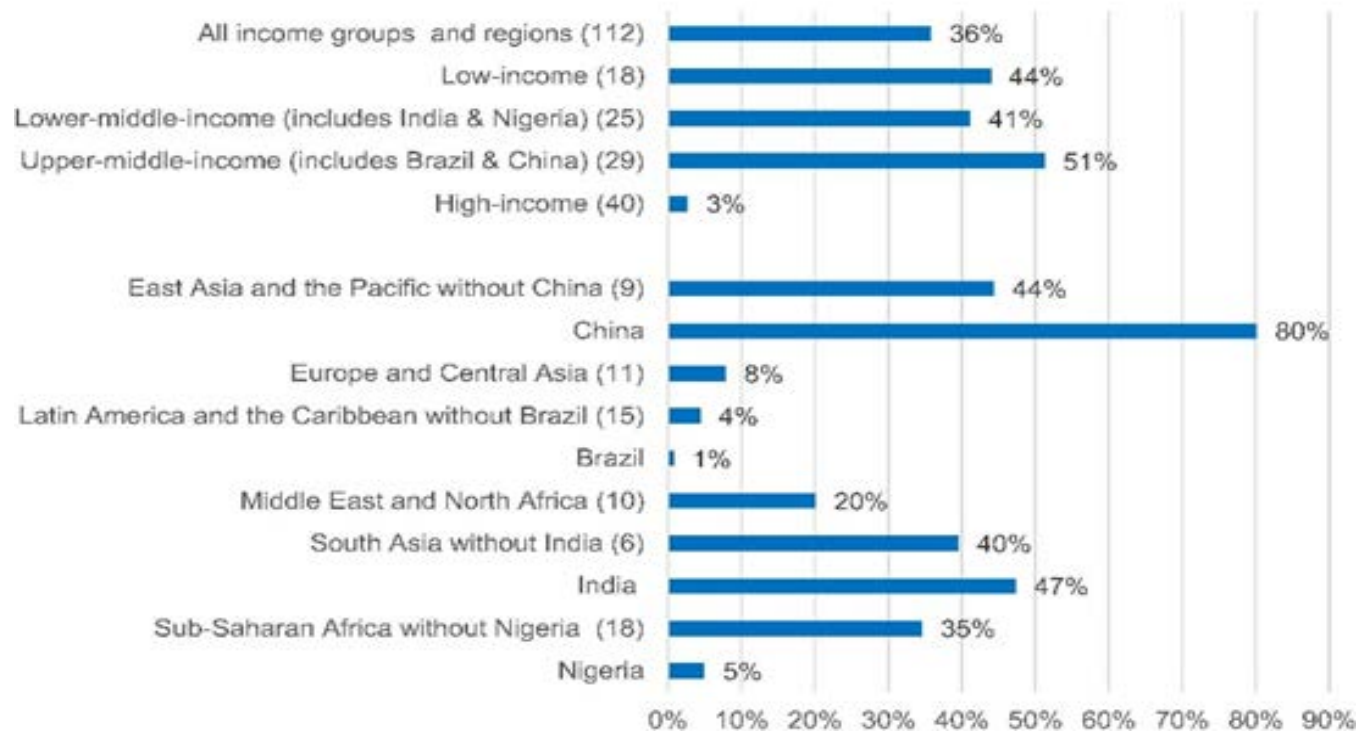
IMPACT
INVESTING FOR
DIVERSIFICATION

SMEs AS AGENTS OF CHANGE

Andrey Kuleshov, CFA

SMEs: IMPACT AT GRASSROOTS

Share of value of food production from smallholders



Source: FAO

- SMEs create more jobs per unit of capital
- SMEs provide food security
- SMEs provide incomes
- Touch the lives of 2.5bn people

FOUR REASONS SMEs LACK CAPITAL

- Commodity SMEs vulnerable: reliance on commodities carries huge costs
- Commodity dependence – persistent outcome of commodity related vulnerability
- Diversification requires investment, but...
- ... SMEs are costly to invest: small tickets, high risks

Diversification for CDDCs requires financing, to change the outcome, change the rules

Impact investors offer new hope

THE LANDSCAPE OF IMPACT PRACTICE

Triple Bottom Line Investing

Impact Investing

PRI

ESG

SRI

ESG: EXAMPLES

There is no one exhaustive list of ESG issues. ESG issues are often interlinked, and it can be challenging to classify an ESG issue as only an environmental, social, or governance issue.

ESG issues can often be measured (e.g., what is the employee turnover for a company?), but it can be difficult to assign them a monetary value (e.g., what is the cost of employee turnover for a company?).

Environmental

- Climate change and carbon emissions
- Air and water pollution
- Biodiversity
- Deforestation
- Energy efficiency
- Waste management
- Water scarcity

Social

- Customer satisfaction
- Data protection and privacy
- Gender and diversity
- Employee engagement
- Community relations
- Human rights
- Labor standards

Governance

- Board composition
- Audit committee structure
- Bribery and corruption
- Executive compensation
- Lobbying
- Political contributions
- Whistleblower schemes

RESPONSIBLE INVESTING

PRI's MISSION:

“We believe that an economically efficient, sustainable global financial system is a necessity for long-term value creation. Such a system will reward long-term, responsible investment and benefit the environment and society as a whole.”



What? – global financial system:

- Economically efficient
- Sustainable

How? – reward investment which is

- Long term
- Responsible
 - Benefit environment
 - Benefit society as a whole

FINANCING FULL RANGE OF OPTIONS

		Impact Investment					
		Traditional	Responsible	Sustainable	Thematic	Impact-first	Philanthropy
		Competitive returns					
		ESG risk management					
		ESG opportunities					
		High-impact solutions					
Focus	Finance Only	← The New Paradigm →					Impact only
	Limited or no focus on ESG factors of underlying investments	Focus on ESG risks ranging from a wide consideration of ESG factors to negative screening of harmful products	Focus on ESG opportunities, through investment selection, portfolio management and shareholder	Focus on one or a cluster of issue areas where social or environmental need creates a commercial growth opportunity for market-rate or market-beating returns	Focus on one or a cluster of issue areas where social or environmental need requires some financial trade-off		Focus on one or a cluster of issue areas where social or environmental need requires 100% financial trade-off
Examples		<ul style="list-style-type: none"> • PE firm integrating ESG risks into investment analysis • Ethically screened investment fund 	<ul style="list-style-type: none"> • "Best-in-class" SRI fund • Long-only public equity fund using deep integration of ESG to create additional value 	<ul style="list-style-type: none"> • Clean energy mutual fund • Emerging markets healthcare fund • Microfinance structured debt fund 	<ul style="list-style-type: none"> • Fund providing debt or equity to social enterprises and/or trading charities 		

IMPACT INVESTING: THE DIFFERENCE

ESG Investment/PRI based strategy

- Can be pursued for financial profit only
- ESG awareness as long term risk mitigation strategy
- Primarily about bringing additional data and analysis into existing approaches

Impact/Ethical/Green Investment

- Financial and non-financial returns explicitly targeted
- Non-financial returns not monetized but reported to conscious investors

INVESTING IN DEVELOPMENT IMPACT

Responsible

- Market rates of return
- ESG indicators *enhance* the risk profile

Impact

- Concessional rates, cover losses
- ESG impact indicators supplement financial return

Non-profit

- Below par rates of return, subsidized
- ESG impact the main indicator

- Development impact funds – from 100% social impact targets towards Triple Bottom Line (TBLI)
- Ambition – to create investable instruments from non-profit activities for private impact investors
- Sustainable Development Goals – common language for coherent collaboration on ESG

IMPACT INVESTING GROWTH

- ESG considerations are not new, increasingly recognized to be a positive factor in asset valuations
- UN's PRI and SDG create publicity and demand for Impact Investments – most major financial players have impact funds
- AUM estimated \$715 billion (GIIN) to \$2.1 trillion (IFC), growth around 20%pa
- “The industry is constrained by lack of instruments” (the Economist, 5 Jan 2017)

CHALLENGE: connect impact investors
to diversification of SMEs in CDDCs

PRACTICING SUSTAINABLE DEVELOPMENT GOALS

The SDGs provide a common framework regarding impact:

- Mapping impact metrics to the SDGs and underlying targets
- Market impact to investors, clear impact expectations for investee companies, contribute to global image of a stronger impact investing industry

Communication about ESG impact of financial investments brings more capital into impact investing

MEASURING ESG/SDG

Tonic E-Guide

- IRIS+ metrics by GIIN
- Global Reporting Initiative/SDG Compass
- Impact Management Project
- GIIRS
- SFDR



IMPACT MEASUREMENT

INSTRUMENTS: FUNDS, GREEN BONDS, IBs

Tailored products whose remit overlaps with areas responsible investment

Part of a responsible investment strategy.

Environmentally- or socially-themed funds

- Standard management compensation ~ 2%
- Lower hurdle rate of less than 10%
- Obligation to report on impact indicators
- Frequently, specific theme for investment, e.g. African Agriculture, SMEs, EcoEnterprises, Agroforestry

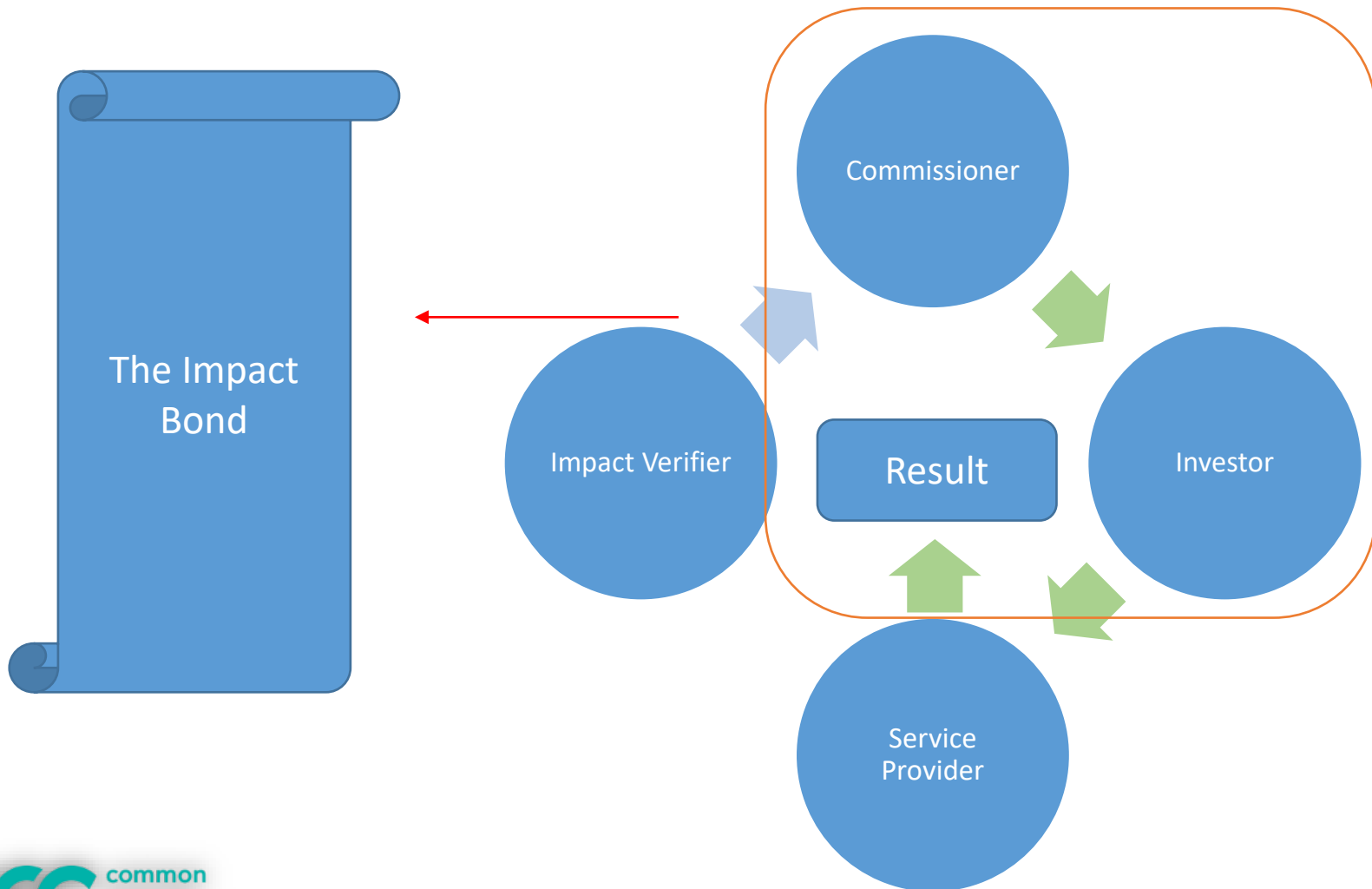
Green bonds

- Finance for projects consistent with Green Bond Principles
- Top credit quality eg. by WB and IFC
- Fixed income returns
- Commitment to transparency and reporting in the use of proceeds

Impact bonds

- Transfers the risk of subsidized projects to investors
- Makes social results directly tradeable
- Returns unconnected with financial markets
- Costly verification – directly material
- COMPLEX MULTI-PARTY LEGAL STRUCTURE

IMPACT BOND



CFC INNOVATION: The Commodity Impact Investment Facility (CIIF)

A new Fund operated by CFC - open to private and public impact investors interested to finance the **transition to a sustainable agricultural system**. Investing in farm-to-fork strategies for climate resilience, innovations, and sustainable trade with high impact on livelihoods.

KEY HIGHLIGHTS

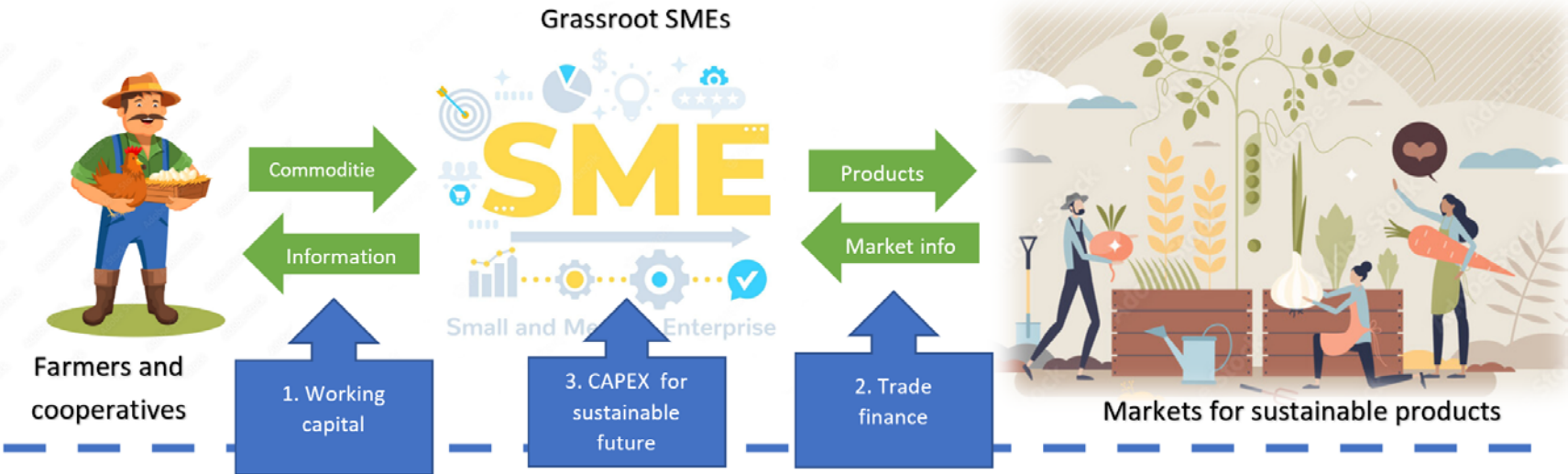


THREE STEPS TO SECURE TRUST WHEN INVESTING IN SMEs

Jobs and income security

Investment and growth

Sustainable future for planet and society



1+2+3 = capital preservation + income



THANK YOU! FOR MORE
INFORMATION

www.common-fund.org