



# CIIX and Impact Investing: Issues and opportunities for institutional investors

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STATE OF THE NATION

# IMPACT INVESTING IN CANADA

**MaRS** | CENTRE FOR  
IMPACT INVESTING



# Spectrum of Social Finance



			IMPACT INVESTMENT		
Traditional	Responsible Investing (RI)	Socially Responsible Investing (SRI)	Thematic	Impact-first	Venture Philanthropy
Competitive Returns					
ESG Risk Management					
		High Impact Solutions			
Limited or no focus on ESG factors of underlying investment analysis and execution.	ESG risks integrated into analysis of all holdings, as a component of financial risk management. Shareholder engagement is used to influence behaviour of holdings.	Negative and positive screening of ESG risks is used to align a portfolio to specific values. Shareholder engagement is used to influence behaviour of holdings.	Focus on one or more issue areas where social or environmental need creates commercial growth opportunity for market-rate returns.	Focus on one or more issue areas where social or environmental need may require some financial trade-off.	Social enterprise funding in a variety of forms, with a range of return possibilities. Investor involvement/support is common.

Source: Purpose Capital adaptation of Bridges Venture Research (2012). The Power of Advice in the UK Sustainable Impact Investment Market. Available at: <http://www.bridgesventures.com/links-research>

# THE IMPACT INVESTING ECOSYSTEM

## INTRODUCTION TO IMPACT INVESTING

### SUPPLY

Who is providing investment and on what terms?

### PRODUCTS

Through what channels is capital matched with opportunities?

### INTERMEDIARIES

How is supply being matched with demand?

### DEMAND

Who is seeking investment and for what purpose?

## IMPACT MEASUREMENT

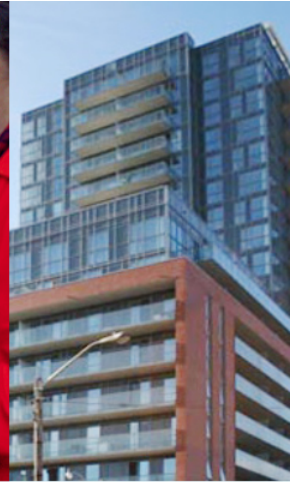
What impact is created?

## GOVERNMENT ENGAGEMENT

How can government enable the marketplace?

## LEADERSHIP

Who is providing leadership to the nascent field?



**Environment  
and Water**



**Financial  
Services**



**Nonprofits and  
Social Enterprise**



**Energy**



**Education**



**Aboriginal**



**Agriculture**



**Health**



**Housing and  
Community Facilities**

# Connecting Demand and Supply



## SUPPLY-SIDE BARRIERS

**Information and understanding:** While most investors understand financial returns, there is a lack of accurate and reliable data about, and understanding of, impact-oriented ventures.

**Costs:** There is a higher transaction cost associated with assessing and understanding social ventures, especially due to the relatively small size of deals in the impact-investing marketplace.

**Access to and awareness of investment opportunities:** As the market is at a stage of uncoordinated innovation, it is challenging for investors to find high-quality impact-oriented ventures in an efficient way.

## DEMAND-SIDE BARRIERS

**Capability and investment readiness:** Social ventures lack the ability to plan for and manage investment.

**Capacity:** Impact-oriented ventures often lack the financial ability to service debt and meet intended financial returns as well as social and environmental impacts.

**Expertise:** Many impact-oriented ventures lack the financial expertise necessary for managing an investment.

**Articulating a value proposition:** Many social ventures are unable to effectively communicate their value proposition.

Adapted from: Burkett, I. (2013). Reaching Underserved Markets: The Role of Specialist Financial Intermediaries in Australia. Foresters Community Finance, Social Traders. Retrieved from [http://www.foresters.org.au/images/stories/publications/2013-03-04\\_intreport\\_web.pdf](http://www.foresters.org.au/images/stories/publications/2013-03-04_intreport_web.pdf)

DEMAND-SIDE FUNCTIONS		FINANCIAL INTERMEDIARY FUNCTIONS	SUPPLY-SIDE FUNCTIONS	
Development & Investment Readiness	Financial Intermediation & Product Structuring	Capital Matching	Pool & Mobilize Capital	Investor Education
Working with social ventures to develop internal capacity and prepare for investment	Designing, developing, structuring and monitoring financial products, platforms and funds	Introducing supply side to demand side actors and coordinating the placement of capital	Coordinating co-investment from multiple investors to reduce risk and transaction costs	Educating investors and their advisors about the range of investment opportunities
     	    	  	     	  

# Challenges for Institutional Investors



1. Early stage ecosystem
2. Small average deal size
3. Fit within asset allocation framework

Figure 17: Track Record of Impact Investment Funds

Source: 242 funds assessed in April 2013  
Note: GIIN, ImpactBase

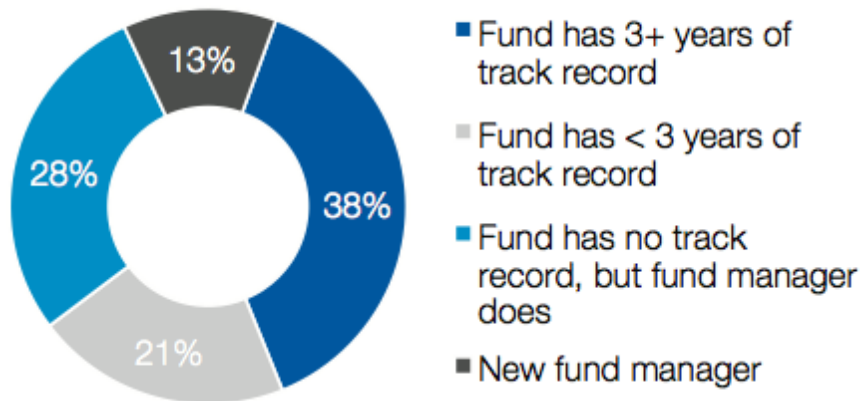
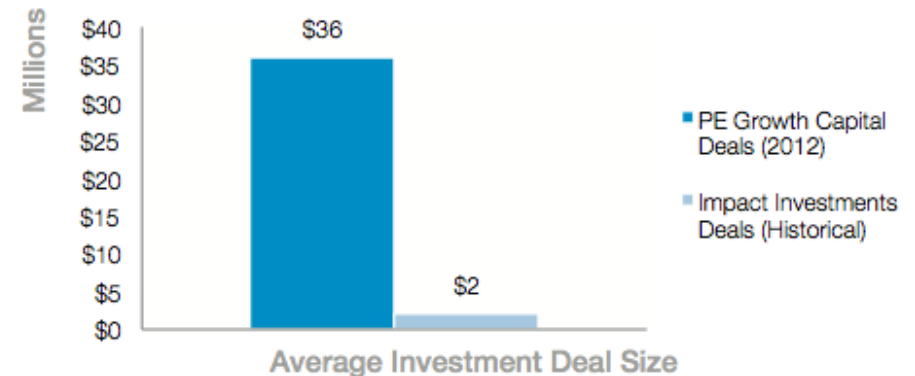


Figure 18: Average Direct Impact Investment Size vs Private Equity Growth Capital Deals

Source: Preqin; GIIN, Deloitte Analysis



Source: World Economic Forum (2013) From the Margins to the Mainstream Assessment of the Impact Investment Sector and Opportunities to Engage Mainstream Investors.



# De-Risking Impact Investing



Performance Expectation	Relevant Risk Factor	Risk Mitigation
Capital preservation, at a minimum, in either real or nominal terms	Capital risk	<ul style="list-style-type: none"> <li>Downside protection</li> <li>Bundling</li> </ul>
Minimal 'unknowns': an understanding of risk factors that are relevant to an investment	Unquantifiable risk	<ul style="list-style-type: none"> <li>Liquidity</li> </ul>
Transaction costs in proportion with potential returns	Transaction cost risk	<ul style="list-style-type: none"> <li>Bundling</li> </ul>
Sufficiently liquid investments to meet uncertain cash flow demands	Exit risk	<ul style="list-style-type: none"> <li>Track record</li> <li>Placement &amp; distribution</li> <li>Technical assistance</li> </ul>
Impact evidence that is sufficiently robust to justify diversion of funds from other opportunities	Impact risk	<ul style="list-style-type: none"> <li>Impact evidence</li> </ul>

Source: Bridges Ventures and Bank of America Merrill Lynch (2014) Shifting the Lens: A De-risking Toolkit for Impact Investment

# Using Long-term Private Debt as an Impact Investment Strategy



1. For investors, long-term private debt offers compelling combinations of tangible social benefits and allows for larger allocations, current yield and more predictable cash flows without investment limitations inherent to early-stage private equity and venture capital.
2. Private debt offers the opportunity to structure legally enforceable covenants around social performance and ensure heightened reporting requirements.
3. For investees, private debt can provide long-term financing, resulting in better planning and financial stability for the borrower and allowing for a longer investment horizon to incorporate more sustainable approaches.

Source: *Building a Strategy: Integrating Impact Investing in the Mainstream Investor's Portfolio* by Ommeed Sathe, Vice-President, Impact Investments, Prudential in World Economic Forum (2014) *From Ideas to Practice, Pilots to Strategy II: Practical Solutions and Actionable Insights on How to Do Impact Investing.* 10

# A Roadmap for institutional investors to get started in impact investing



## VISION & LEADERSHIP

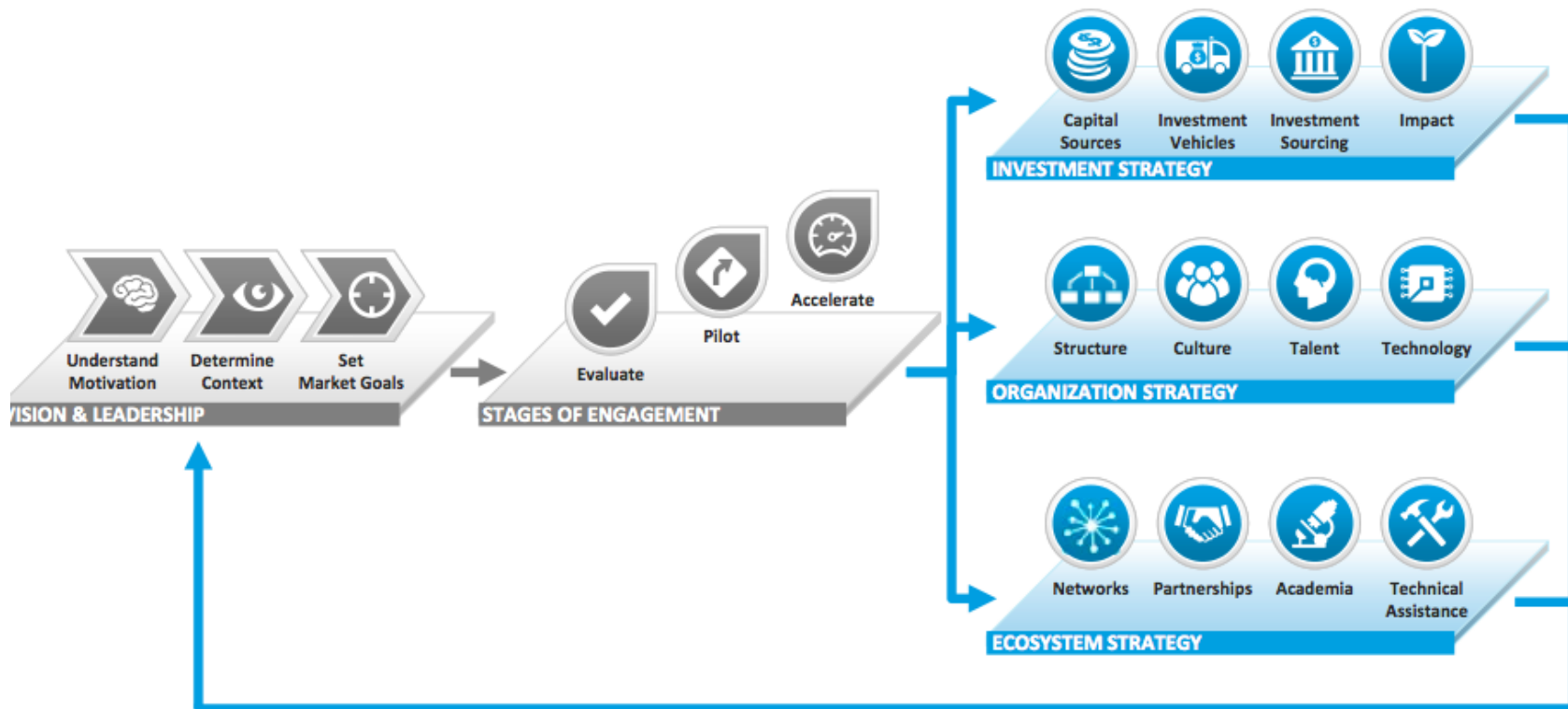
*A clear vision for impact investing should be defined, upfront...*

## STAGES OF ENGAGEMENT

*...allowing for stages of impact investing to be pursued, according to organizational goals and constraints...*

## TACTICAL MAPS

*...which in turn will help the organization clarify the roadmap to impact investing.*



*Leadership should continue to evolve and progress the vision as the organization matures through stages of impact investing.*

Source: World Economic Forum (2014) Charting the Course: How Mainstream Investors can Design Visionary and Pragmatic Impact Investing Strategies,

# Policy Levers for Change



Barrier	Lever	Example
Fiduciary duty	Clarification of fiduciary duty	<ul style="list-style-type: none"> <li>• South Africa: Regulation 28, where ESG factors explicitly linked to fiduciary duty)</li> </ul>
	Fiscal incentives	<ul style="list-style-type: none"> <li>• Nova Scotia: CEDIFs (35% tax credit)</li> <li>• UK: Social Investment Tax Relief</li> </ul>
Compliance	“Opt-out” as standard	<ul style="list-style-type: none"> <li>• France: Employee savings plans invested into community funds / social enterprises (5-10%)</li> </ul>
Disproportion- al transaction costs	Bundled or multi- asset products	<ul style="list-style-type: none"> <li>• UK: Big Society Capital formed with USD \$1BN as wholesaler for social finance sector</li> </ul>
Capital risk	Matching capital, first loss layers, guarantees, investment readiness	<ul style="list-style-type: none"> <li>• Many examples of first-loss structures in US affordable housing e.g. NYC Acquisition Fund</li> <li>• UK: Investment and Contract Readiness Fund</li> </ul>

Source: Clara Barby and Mads Pedersen (2014) Allocation for Impact: Subject Paper of the Asset Allocation Working Group (2014)