BIZCOMMUNITY

WEF Africa's inclusive economic growth target achievable with three-dimensional investing

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With the volatility of the global economy and the increasing social sensibility of shareholder communities, smart fund managers have started to consider including a clear component of shared value within their asset portfolios. This is driving significant interest in Impact Investing with the term having gained further momentum since the Global Impact Investing Network ("GIIN") was conceived in October 2007.

Impact Investing has broadly been defined as an investment approach that intentionally seeks to create both financial return and positive social or environmental impact that is actively measured. It is currently widely discussed at conferences and investment meetings globally with a diverse range of opinions as to what exactly constitutes positive impact and how it can be optimally measured.

Notwithstanding these ongoing debates, it is evident that due to diminishing natural resources, growing populations and increasing economic inequality, investors are increasing mindful of the need to create positive impact in order to promote sustainable economic, environmental and social development and to provide capital to address the world's most challenging issues in sectors such as sustainable agriculture, renewable energy, conservation, microfinance, and affordable and accessible basic services in housing, healthcare, and education.

This was certainly highlighted recently at the World Economic Forum (WEF) on Africa 2017 where the requirement to develop solid strategies to mitigate the skills gap and drive sustainable job creation opportunities was a core theme. The acknowledgement that more innovation in facilitating solutions to the infrastructure build out, education gap, entrepreneurship and enterprise development are needed, was a key out-take of the WEF Africa 2017 and speaks directly to an impact investing approach.

What is Impact Investing?

While the terms has been thrown around fairly loosely in the last decade or so, the GIIN outlines four core elements of impact investing:

- **Intentionality:**

  An investor's intention to have a positive social and/or environmental impact through its investments is a key component.

- **Investment with return expectations:**

  Impact investments are expected to generate a financial return on capital or, at minimum, a return of capital.

- **Range of return expectations and asset classes:**

  Impact investments target financial returns that range from below market to risk-adjusted market rate, and can be made across asset classes (e.g. cash equivalents, fixed income, venture capital, and private equity).

- ## Impact measurement:

  A feature of impact investing is the investors’ commitment to measure and report the social and/or environmental performance and progress of underlying investments, ensuring transparency and accountability while informing the practice of impact investing and building the field.

Measurement of impact is central to impact investing although the type and extent may vary depending on the investors’ objectives and capacities. The selection of what to measure from the outset is usually reflective of the investors’ goals and intentions.

For example, an investor interested in uplifting the education standards and university entrants in selected low-to-mid income households would track the number and income levels of pupils receiving improved quality education at an affordable price point from an education investment. It would also consequently monitor the impact of its academic results out-performing a target benchmark level.

Why measure for impact?

In addition to impact measurement being essential to track social and/or environmental goals, it also has inherent commercial advantages which have been outlined in a recent report published by the GIIN, “*Business Value of Impact Measurement”* (June 2016).

The report profiled numerous market leading impact investing investors that demonstrate increasing sophistication in the way they apply the data generated to manage impact outcomes of investees and to improve the performance of the underlying businesses in the following five areas:

1. Revenue growth:

- By focused tracking of investee companies’ customer base in terms of their contexts, socioeconomic status, access to services, and preferences related to the companies’ products and services, additional revenue growth can be driven in a variety of ways.
- This information helps businesses to better segment customers, to develop targeted marketing strategies, to access new market segments, and to develop and refine product and service offerings.

2. Operational effectiveness and efficiency:

- Impact investors and their investees use social and environmental performance data to inform and improve operational effectiveness and efficiency at the level of the investee company or project.

3. Investment decisions:

- Impact data can improve aspects related to investment decisions—including deal targeting, selection, and sourcing.
- Data related to potential or actual social and environmental impact can help investors to determine which sectors and which deals, are likely to provide the type of impact and financial performance they seek.
- Measuring and communicating impact can also help expedite deal sourcing.

4. Marketing and reputation building:

- Data on social and environmental impact can prove beneficial to investors and investees for marketing and earning trust with important stakeholders, helping them raise capital, smooth entry into new markets, and speed processes involving local authorities.

5. Strategic alignment and risk mitigation:

- Impact measurement plays a critical role in ensuring investors' and companies' activities are aligned with their mission and strategy, as well as in mitigating risks that relate to both impact and financial concerns.
- Monitoring social and environmental performance can provide early insight into overall business performance, offering an opportunity to correct course and prevent losses.

In line with the aforementioned education investment example, the impact performance metrics can then be used to market the education facility to its selected customer segment and attract more pupils, thereby enhancing returns. The report further indicates that including impact metrics into investee reporting can have notable commercial benefits in addition to measuring and monitoring social and/or environmental objectives. Consequently, impact investing principles can potentially add value to a much broader spectrum of investments.

Conclusion

Key accepted investment considerations have evolved over the past 150 years from a predominately one-dimensional focus on return towards two-dimensional risk/return assessment criteria. Given the momentum to align social and environmental considerations with investment fundamentals as well as the potential commercial value of tracking such metrics, it appears that the next conventional investment framework could comprise a three-dimensional approach: risk, return and impact - thereby creating a New Efficient Frontier.

As technological developments continue to improve the efficiency - and to reduce the cost - of monitoring impact metrics, all investors (traditional and impact) should consider incorporating some form of three-dimensional approach along the impact continuum into their investment strategy to potentially enhance short term returns and long term economic sustainability.

In fact, the World Economic Forum Africa 2017's recent focus on the urgent need for youth job creation and inclusive economic growth to build a sustainable continent, highlights that investors must enhance their strategic parameters to include social development indicators. Now, more than ever, impact investing principles are well positioned to emerge out of the investment fringes and into the main stream.

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