Episode 1: Doing well by doing good

A growing demand for social impact while seeking financial returns

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PERSPECTIVES

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In summary

The social and environmental issues that we currently face constitute major challenges that raise questions for all of us. When it comes to these issues, we no longer have a choice: we need to find innovative solutions to tackle them.

Today, philanthropists are no longer the only ones addressing social and environmental issues; financial investors are now fully fledged players in this challenge.

Why? Because it has now been proved possible, and not at all contradictory, to combine social and economic performance in an investment. Indeed, key players in the public and private sectors have seized the opportunity offered by impact investments. They see impact investing as a major tool to catalyse the change of scale needed for innovative responses to fundamental issues.

This paper is aimed at providing a first insight as to how stakeholders (regulators, investors and social entrepreneurs) are working together to create a professional ecosystem looking to improve society while generating financial returns.

Over the next episodes of this series will deep dive on the main sectors, the challenges of social impact measurement and the financial innovations related to this market.

A. Impact investing refers to investments with an intentional positive impact on people and/or the environment, taking place via sustainable and profitable initiatives and subject to evolving impact measurement.

B. In 2018, this market was estimated at $502 billion, a market eight times larger in just five years.

C. This growth has been mainly driven by (i) growing social consciousness in our society regarding environmental issues, (ii) new and traditional investors searching for ways to contribute to society in order to complement limited public spending to address these problems alone and (iii) growing interest for responsible and economically sustainable business models.

D. However, this sector is facing lots of new challenges such as how to appropriately measure social impact, the necessity for a legislative framework and the constant need for innovative solutions.

1 The current impact investing market

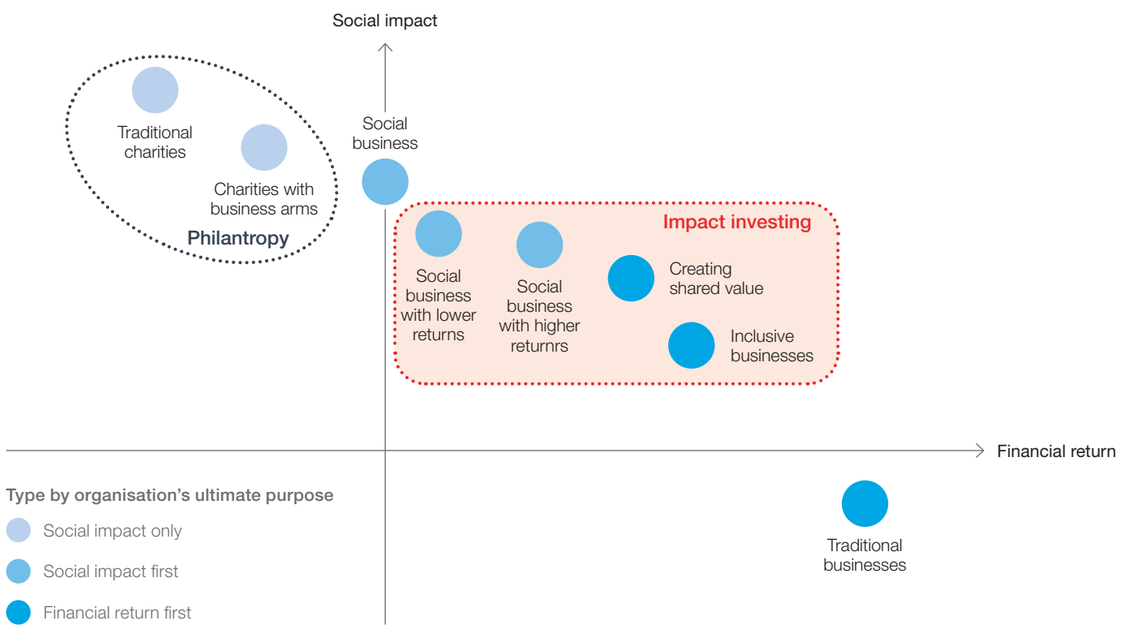
a Impact investing: much more than just a trend

Impact investing is undoubtedly a concept with various and evolving definitions. The Rockefeller Foundation used the term for the first time in 2007 during a conference organised to evaluate the possibility of developing a type of investment with a social and environmental impact.

The Global Impact Investing Network (GIIN) defines impact investing as an investment that explicitly combines social return and financial return. More concretely, it refers to investments with an intentional positive impact on people and/or the environment, taking place in sustainable and profitable businesses and subject to proactive impact measurement before, during and after the investment (greenhouse gas emissions avoided, number of jobs created, etc.). This type of investment aims to break the usual practices of financial players who used to either give money away without any expectation of financial return ("doing good") or invest money as well as possible to maximise financial returns ("doing well"). Impact investing is therefore doing good and doing well at the same time.

It is essential to disassociate impact investing from socially responsible investments. The purpose of the latter is to exclude from investment portfolios certain companies that may be less virtuous than others or to choose, in each sector, the "best in class" according to extra-financial criteria. Unlike socially responsible investments, impact investing concerns companies where investors prioritise not so much "return" but "meaning". It is necessary to understand the differences between those companies that claim to be "green" because they apply environmental, social and governance filters when they screen financial deals and those companies whose true ambition is to create positive social and environmental impacts.

Spectrum of business based on social impact and financial return



Source: "Financial performance of impact investment" market study 2017-2018 and Accuracy analysis

b A growing $502 billion financial market

The impact investment market has grown significantly in the last decade. In terms of assets under management, GIIN estimated a market of $60 billion in this sector in 2014 [1]. This figure increased to $228 billion in 2017 [2] and $502 billion [3] in 2018, a market eight times larger in just five years.

The graph below highlights the diversification of the investments in this sector. Impact investors have different asset allocation strategies, investing across geographies, sectors and types of instruments.

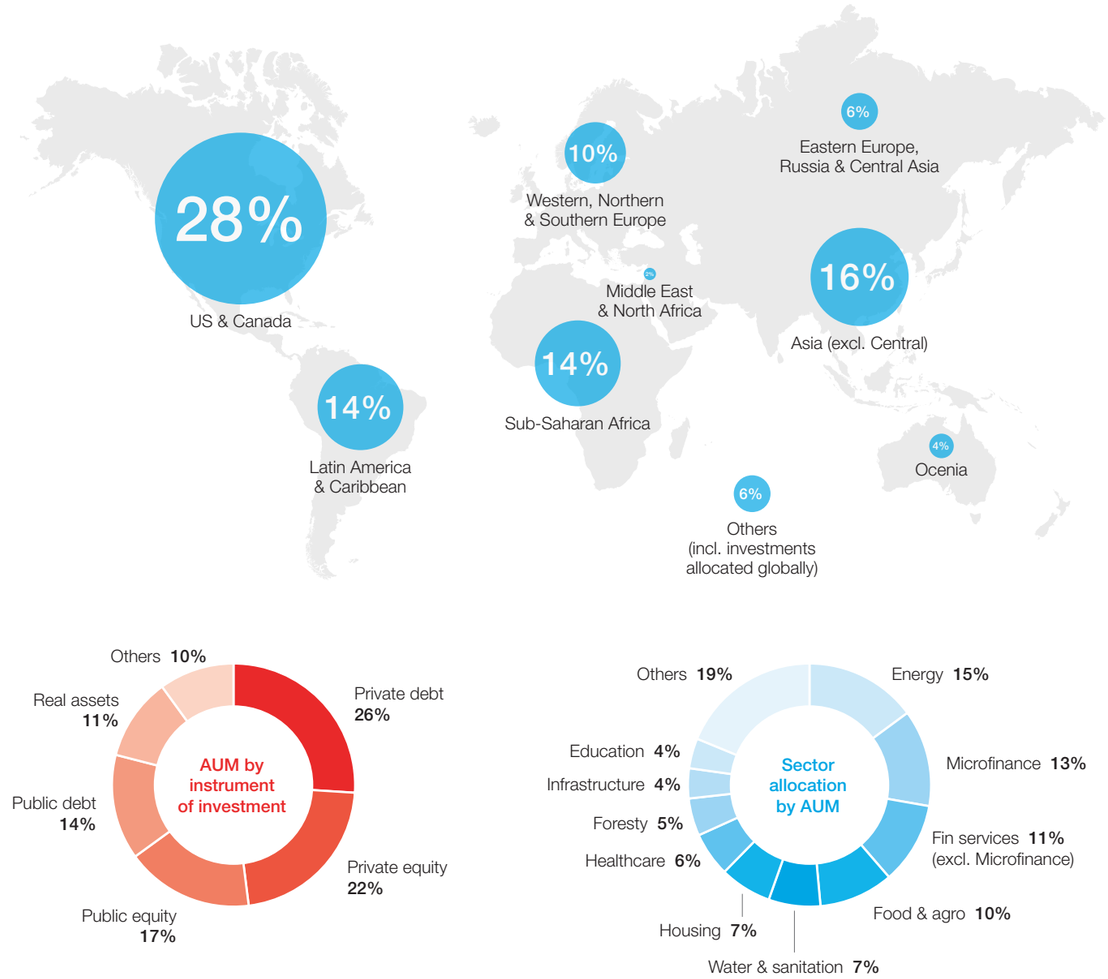
Notes

1) The Impact Investor Survey – Global Impact Investing Network and J.P. Morgan - May-2015

2) Annual Impact Investor survey – Global Impact Investing Network - 2018

3) Sizing the impact investing market – Global Impact Investing Network - April 2019

Assets under management ("AUM") by geography, sector and instrument



Source: GIIN 2019 Annual Impact Investor Survey and Accuracy analysis

A growing $502 billion financial market *(cont.)*

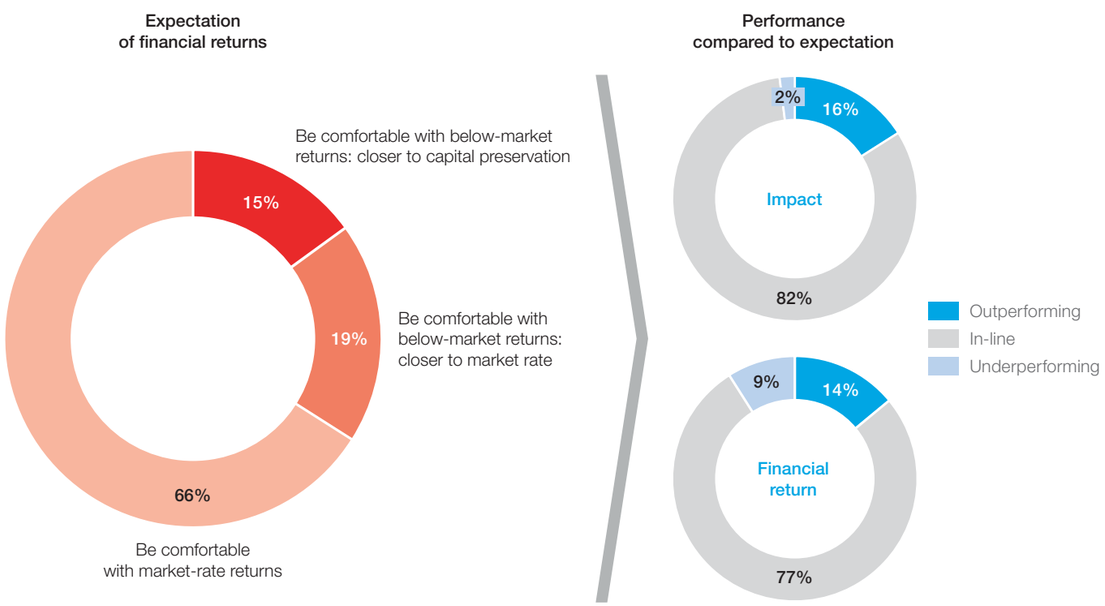
Regarding return on investment, contrary to the general belief that impact funds generally underperform traditional investment funds and do not necessarily seek market returns, GIIN published a study "Global Impact Investing Network – 2019" whereby it shows that 66% of impact funds seek market-rate returns. Moreover, 77% of the funds performed in line with their expected financial return and 14% outperformed expectations [4].

In Europe, the UK has pioneered in impact investing benefitting from an innovative and growing market since the 2000s thanks to numerous political and regulatory initiatives, followed by Northern European countries, like Sweden, and Western European countries like France, the Netherlands and Switzerland.

Note

4) Annual impact investor survey 2019 – Global Impact Investing Network - 2019

Expectations vs. performance



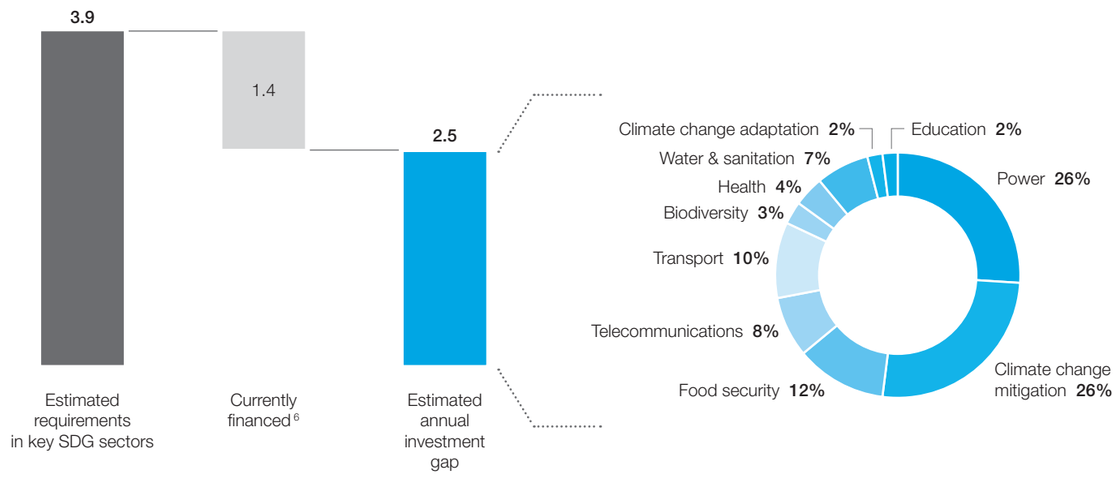
Source: GIIN 2019 Annual Impact Investor Survey and Accuracy analysis

Consciousness + opportunity + search for meaning: three key growth drivers

The question that now comes to mind is the following: why is this market growing today? Our analysis demonstrates that two worlds are converging. First, the world of finance, which has experienced many setbacks since 2007, is seeking to include ethical considerations in its investments; it is discovering the impact investment as a business model capable of generating social wealth with more secure long-term profitability. Second, the world of social entrepreneurs, who are now able to generate profitability and a strong social impact, wishes to free itself of public finance (which is more and more limited). This convergence has been driven by several factors.

- First, society is now more conscious that economic growth aspirations are outpacing global resource supplies. Currently, we consume 1.7 planets' worth of resources [5] and, consequently, we are facing challenges such as climate change, resource depletion, biodiversity loss, consumption patterns, pollution and waste management, supply chain fairness and widening income inequality. The United Nations explained that significant resources are required to address these challenges. The Sustainable Development Goals (SDG) gap provides opportunities for private capital to supplement public funds.
- Second, as proved by the United Nations, social public spending is no longer growing as fast as is necessary. Charitable donations and public aid are no longer sufficient to tackle global social issues.
- Third, world leading investment firms are increasingly attracted to responsible business models and socially responsible returns. Not only does this add another layer of motivation to their staff but it also provides new business opportunities. These players are able to bring an outstanding talent pool to assist in the development of new opportunities with a long-term view on sustainability and social impact. The development of a more socially responsible form of finance is also a response to the excesses of the financial sector highlighted by the 2008 crisis.

Estimated capital requirement – Potential private sector contribution (USD trillion)



Notes

5) Ecological Footprint — The Global Footprint Network

6) Financed by public and private investment.

Source: World Investment Report United Nations Conference on trade and development 2014 and Accuracy analysis

2 The future of this growing market

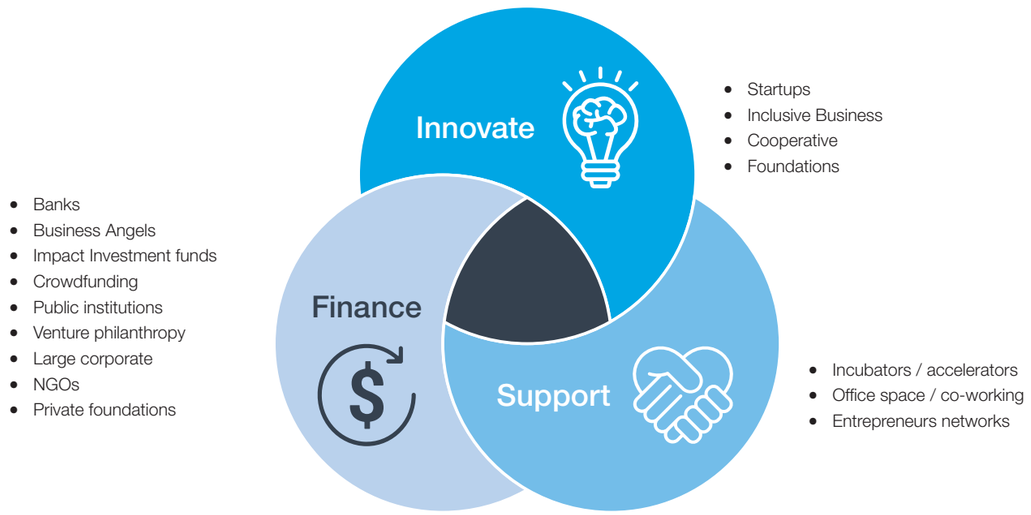
a Innovate, finance and support – the new players in the game

The growth of this sector has created a new innovative and large ecosystem that includes more and more players and solutions. These new players are helping to put in place the tools that promote a more efficient functioning of this market. This new ecosystem is mainly composed of entrepreneurs, investors and support structures.

Previously considered as a "niche" for a few specific social investors, impact investing is now a new market for "traditional" investment funds. For example, a leading global investment firm announced in February 2020 the closing of its Global Impact Fund at $1.3 billion. This fund is dedicated to investments in companies with business models aimed at providing solutions to environmental or social challenges. In the same month, another leading investment fund announced its intentions to direct its investments towards companies committed to impact investing.

In addition, the EU has reached an agreement to establish European rules defining sustainable investments. This new framework (due to be in place by 2021) would give a "green" label for investments that cover renewable activities; it would grant lower labels for investments that are not fully renewable but help to reduce CO_2 emissions.

Impact Investing ecosystem



Source: Accuracy analysis

b The main challenges for a better future

What challenges does impact investing face? The first is the impact measure itself. Due to its specific characteristics, financial players must adopt a new logic: the objective is to generate returns on financial investment while obtaining the greatest possible social impact. One of the key challenges for this is to measure social impacts in the same way financial impacts are measured, that is with some form of tangible metric. Several options are currently being explored in order to measure the "Social Return On Investment" (SROI).

The second challenge relates to the legislative framework and public incentives. The legislative framework should be adapted to allow and enhance the development of impact investing worldwide. One good example of this was introduced in the UK in April 2014 with the Social Investment Tax Relief (SITR), a tax reduction of up to 30% of the investment for individuals who invest in small social enterprises.

The third challenge relates to completing the funding chain of social companies. Like traditional investment funds, the majority of impact funds choose to finance companies either in the growth stage or to finance mature companies. Indeed, mature companies represent approximately 55% of assets under management and companies in the growth stage represent 34%, but companies in the venture and seed stages represent only 9% and 3% respectively [7]. Therefore, the ecosystem needs to complete the social entrepreneurship funding chain so that appropriate funds are available at all the key development stages of a social enterprise.

The fourth challenge concerns the financial world's need to continue innovating in order to find available liquidities for impact investment players. An example of these are Social Impact Bonds (or "Pay for Success Bonds") which pursue the objective of raising private capital to finance public social actions. Social Impact Bonds intend to fund activities, which, if not carried out, will result in future costs for public authorities. The first Social Impact Bonds were launched in the UK. The project goal was to provide re-entry services to prisoners leaving prison. The bond is remunerated on the basis of a fixed and clear objective: to reduce offense recurrence by 10%. If the objectives are achieved, public authorities reimburse investors with capital, at a specific rate computed based on the savings made by the public authorities thanks to the bonds. However, if the objectives are not achieved, private investors lose the investment.

Note

7) Annual impact investor survey 2019 – Global Impact Investing Network - 2019

Conclusion

All stakeholders in this innovative ecosystem have a role to play in promoting this new dynamic investment market. Financial intermediaries like banks, financial players, financial and strategic advisors and accounting firms, must also better understand how impact investing can become a vector of progress.

Companies focused on impact investing are clearly here to stay. They aim to have an impact on our society and at the same time earn a return for their investors. However, the road ahead is long and there are many challenges to establish a common framework to enhance this blooming ecosystem.

The current pandemic will increase social issues. It will also force countries to rethink and redesign how we define the economy and how we assess value. Now is the time to capitalise on this sector in order to build markets that ensure sustainable growth for all. Now is the time to do "well" by doing "good"!

About Accuracy

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