

IMPACT INVESTING

**From philanthropy
to profit :** **1**

The evolution of socially
responsible investment

Measuring impact: **5**

How industry bodies and
investors are trying
to gauge social return

The full report: **7**

Investors remain unconvinced
that social impact enhances
financial returns



**THIS REPORT WAS
FINANCIALLY SUPPORTED
BY THE ROCKEFELLER
FOUNDATION**

THE BRIDGE BETWEEN PHILANTHROPY AND PROFIT

Impact investing, which aims to solve social or environmental problems while generating a profit, is on the rise and starting to attract institutional investors

BY PADDY PARTRIDGE

While announcing his vision for a new 'creative capitalism' at the World Economic Forum in 2008, Bill Gates observed that "there are two great forces of human nature: self-interest and caring for others". Historically, these forces, especially when ascribed to finance and philanthropy, have been considered incompatible.

The recent rise of impact investing – deploying capital to support enterprises that generate social or environmental impact as well as a financial return – does however represent a convergence of these once polarised concerns.

Over the last few decades, addressing social and environmental challenges has become progressively more aligned with financial return. Since its emergence in the 1970s, Corporate Social Responsibility, or CSR, has become a household acronym. It is now almost impossible to find an annual report of any big international company that justifies the firm's existence solely in terms of profit,

rather than "service to the community" or "environmental performance".

Socially Responsible Investing has also entered the mainstream. Initially SRI just involved 'negative screening', the removing of 'sin stocks' like tobacco and pornography from one's portfolio. Now 'positive screening', including companies that promote social or environmental sustainability, is becoming more popular. Despite the recession, assets under management by SRI funds in Europe rose by 41 percent to \$107bn in the 12 months to June this year, according to research by Vigeo and Morningstar.

These developments have been inspired both by a more mainstream ethical approach to business and finance, and by sheer pragmatism. The Skoll Foundation, like many, believes "that companies that do not acknowledge and manage their environmental, social and governance risks are at a significant long-term financial disadvantage."

As resources become scarcer and Western consumers more values-driven this view



LEFT: A grocery store in Monrovia, Liberia

is more widely held.

Meanwhile, in the international development sphere, traditionally regarded as the domain of governments and charities, the private sector is being asked to take on more responsibility. Private sector rigour and transparency is also more widespread.

In October Andrew Mitchell, UK Secretary of State for International Development, launched "a new DFID culture of private sector-led development". "I want DFID to learn from business" he said, and to "inject new, business-savvy DNA into the department."

This trend is also apparent among philanthropists and foundations. "Market-based solutions to poverty" is now a key mantra for organisations such as the Clinton and Gates Foundations. Former champion of aid Sir Bob Geldof is trying to raise \$1bn for private equity venture 8 Miles that will focus on agribusinesses, financial services and telecommunications in sub-Saharan Africa.

Impact investing represents a coming together of these shifts in attitude. According to the Global Impact Investing Network – "impact investments aim to solve social or environmental challenges while generating financial profit". As such they are both a more proactive form of SRI and a more entrepreneurial, private sector-led approach to tackling poverty and other social challenges.

Broadly, investors fall into two categories: Firstly, "Impact first" investors, who aim to maximise social and environmental impact and are prepared to accept below market-rate returns. These are investors without fiduciary responsibilities who will often use non-profit vehicles such as the Acumen Fund, E+Co and Root Capital. On the other side, there has been a recent surge in "Finance First" investors. These tend to be commercial investors who seek investment vehicles that offer market-rate returns while secondarily generating social or environmental impact.

Investments can range from E+CO investing \$270,000 worth of debt in a West African company that manufactures energy-efficient cooking stoves, to TIAA-CREF, a vast US pension fund, investing \$40m into a microfinance equity fund.

This form of investing is not essentially new. Development finance institutions, such as the IFC and the UK's CDC have ➡➡

PHOTO: CORBIS

been involved for at least 50 years. They have demonstrated decent profits through high-risk, development-orientated investments in emerging markets. Mohammed Yunus famously founded the Grameen Bank in late 1970s. Clean-tech investments have been attracting big money since the Millennium.

What is new, however, is the change in perception towards these kinds of investments and the idea that impact investing now represents a homogenous industry.

Impact investments are no longer the reserve of philanthropists, governments and DFIs. Nate Schaffran, Africa director of Root Capital, a non-profit fund that invests in SMEs in the agriculture sector, says: "Five years ago the industry was dominated by DFIs and foundations. Now we are seeing a new class of investor: fund managers and wealth managers."

Suddenly with success stories, such as the IPOs of Compartamos and SKS – two microfinance institutions that between them raised over \$800m – these kind of investments are starting to attract larger institutional investors.

After the recession many investors are looking to impact investments to diversify their portfolios. Neil Sandy, COO of Truststone Asset Management, says that part of the attraction to institutional investors is the "realisation that these types of investments can be relatively uncorrelated to world stock markets". Crucially, many of these investments are also in emerging economies, such as India and South Africa, which currently boast growth rates up to three to four times those in Europe.

It is perhaps no surprise then that GIIN, the major impact investing network, now boasts Morgan Stanley and JPMorgan as members, as well as more explicitly social investors Root Capital and Acumen Fund.

As the number and diversity of investors have increased, so too have the asset classes and sectors involved. Investors are no longer just interested in the traditional impact investments of equity in clean-tech start-ups or microfinance loans. As Amit Bouri at GIIN says, "African agriculture has a great deal of buzz" and sectors, such as housing, education and health are beginning to emerge.

This growth in interest is reflected by an increase in the number and scale of funds involved. According to Jacqueline Novogratz, the founder of Acumen Fund, 192 new social impact funds were launched in the last three years alone. After the US's early lead, many of these new funds are European or from other emerging markets. This sudden surge in interest has led Monitor Institute to



LEFT: A Gabonese fruit vendor sells her produce at a street market in Libreville
BELOW: Microsoft founder Bill Gates



QUICK STATS

192

The number of new social impact funds launched in the last three years.

Source: Acumen fund

11%

of assets under management in the US are in Socially Responsible Investing funds.

Source: Nelson Information

This sudden surge in interest has led Monitor Institute to predict the market size of impact investing could be as big as \$500bn in just 10 years time – around 1 percent of the world's total assets under management

predict the market size of impact investing could reach \$500bn in just 10 years time – around 1 percent of the world's total assets under management. However, for this to happen some considerable obstacles will need to be overcome.

As with most nascent industries the current framework for impact investment is still very basic and fragmented. There are only a very limited number of independent third-party sources of information or investment consultants; there is a complete lack of clearinghouses and syndication facilities; and a common language for impact investment is yet to emerge. All of this makes it difficult to communicate opportunities, successes and failures and greatly increases transaction costs for investors.

The lack of a common vocabulary and the inherent difficulties associated with evaluating social and environmental impact means that for investors it remains very

difficult to assess how much impact they get for their money. It is also almost virtually impossible to compare the performance of funds on any basis other than financial. Larger pension funds may demand more rigour in this area before they are tempted to join the fray.

Steps are being made to address these problems. GIIN is trying to create a universal lexicon for impact investing. This would help standardise what it means when an organisation says they have created new jobs or improved the quality of healthcare in a village.

Similarly B Lab, a US non-profit, has developed a social rating system for funds that they hope will be used in a similar way to Standard and Poor's credit ratings.

As with many forms of investment in developing countries, another problem is the lack of absorptive capacity. At the moment impact investments rarely offer the chance

to invest the kinds of sums that private equity firms are used to playing with. Similarly, there are few businesses with proven investable business models. As a result many investors complain they are looking at the same companies as dozens of other impact investors.

Brian Trelstad, chief investment officer at Acumen Fund, says that when the firm began making investments in India and East Africa in 2002, "there was a pent up demand for investment from social entrepreneurs. Now the availability of capital is outstripping the number of entrepreneurs". He believes that this balance is gradually being redressed as the capital starts to attract new entrepreneurs, but this will, of course, take time.

This problem seems to be more acute in Africa than elsewhere. Funds, such as Grofin and SEAF, which both invest in SMEs in Africa, have to build substantial capacity

to support entrepreneurs before and after investing with basic business training and strategic advice. Nate Schaffran also complains of a lack of human capital of managerial quality. Unlike in South America, he says, "you will find very few trained accountants in places like rural Uganda".

Liquidity can also be a problem in many African countries where impact investing is becoming more prominent. Often exit opportunities for those who have invested equity are few and far between.

In spite of all of these challenges there is great hope surrounding the industry. It represents an exciting new way to financially engage with developing countries and channel private funds towards social and environmental needs. It is unlikely to replace old fashioned philanthropy but it will, as Amit Bouri says, "liberate aid dollars and allow them to focus on the areas that need it most".

PHOTOS: AFP/GETTY IMAGES/CORBIS

THE DIFFICULT TASK OF MEASURING IMPACT

Effective methods for measuring impact are being developed, but a standardised system remains elusive

BY ANNE STUBERT

Anthony Bugg-Levine, managing director of the Rockefeller Foundation, recognises that “the power of metrics is that it enables us to deploy our marginal dollar to the best problem-solver, not just the best storyteller”. While this attitude is driving impact investment forward as an industry, the road to better evaluation and measurement is littered with potential pitfalls.

Can all of the benefits of an investment really fit into any simple metric? How does one rate intangibles such as a stronger feeling of security among the women of Sudan as a result of a peace building programme? How can one effectively compare the performance of, say, a healthcare programme in Brazil with a water and sanitation programme in Malawi? The challenges can at times seem insurmountable.

Over the past years, financial sector perspectives, particularly from the private equity and venture capital industries, have

gained traction in the impact investment field. As with the financial sector, there is a need for impact investors to forecast social value, track and evaluate performance over time and assess past investments.

This influx of financial rigour has led to an impressive knowledge base and to the development of more sophisticated systems with which to measure impact. These efforts cover a variety of cost-effectiveness and cost-benefit analysis.

While the development finance institutions, such as the IFC, have paved the way in recent decades, many new systems have emerged in the last few years. The social venture fund Acumen has developed the BACO Ratio, which quantifies investments' social value and then compares it to other opportunities in the same sector. Meanwhile, the American philanthropic fund REDF has created the tool SROI, which calculates social return on investments.

In spite of these developments a com-

mon global standard for measuring social impact remains elusive. There is still a lack of transparency and consistency in how investors define, track, compare and report on social value. While one organisation might define outputs like job creation as any employment opportunity, including seasonal jobs, other organisations might only include full-time jobs. Problems like these make it very difficult for investors to compare the social value performance of different funds.

To address these concerns, a group of leading investors, headed up by the Rockefeller Foundation, developed IRIS, a common framework for defining and reporting on social impact. The initiative provides specific metrics for a number of different sectors, including health, energy and education. It will also gather social impact data from its partners and publish benchmarking reports allowing investors to compare investment opportunities.

If impact investing is to attract the big pension funds and other institutional investors, then it must become easier to compare investment opportunities. That is why the Global Impact Investing Rating System was founded. GIIRS is an independent third-party impact rating agency. As Beth Richard-

ter rating than treating one suffering from malaria?

Standardised measurements will also undoubtedly generate “winners and losers”. Short-term outputs, such as the number of microfinance loans granted in a village, are much easier to measure than long-term outcomes, such as the effect that those loans have had on poverty, economic growth and quality of life in that village. Investments in sectors in which the results are easier to measure, and programmes which generate impressive short-term results, will probably end up attracting more capital than others.

Quantitative results are easier to capture than qualitative results. Some argue metrics like these “reduce people to numbers” and fail to capture immeasurable benefits. What about more intangible outcomes like the empowerment of women? Is there also a risk that more emphasis on metrics would encourage grantees to work toward short-term results, such as building water pumps, without addressing the fundamental goal – sustainable water management?

Marie Rosencrantz, monitoring and evaluation expert, emphasises the challenge of actually gathering data. Many promising organisations and programmes lack the infrastructure and the resources to collect sufficiently robust data to meet reporting standards. It is therefore crucial that investors and investees agree on a limited number of metrics, in order to avoid placing an unnecessary burden on grantees. As the CEO of Acumen Fund Jacqueline Novogratz puts it: “The art of measurement is in knowing which measures to select, when to look at them, and what decisions to make based on the data and our experience.”

Despite these difficulties, the benefits of a global system for measuring impact are significant. Allowing investors to measure and compare the social impact of different organisations would attract more capital to the impact investment sector and open up the sector to institutional investors like pension funds and hedge funds. This clarity would also increase the credibility of the sector and strengthen the relationship between the investor and the investee, allowing more consistent discussion around performance.

Possibly the greatest benefit of a standardised system of measuring impact would be a better understanding of how to increase the social value of investments in developing countries. In order for the impact investment sector to thrive and address some of the major development challenges in the world, a robust system and infrastructure to absorb and share assessment will be key.

If impact investing is to attract the big pension funds and other institutional investors, then it must become easier to compare investment opportunities

son, its director, says: “If IRIS is a financial standard, GIIRS can be thought of as a rating system like S&P or Moody’s.” So far, GIIRS has selected 25 fund managers, representing \$1.2bn in assets under management, with investments in about 200 companies in emerging markets. In January 2011 these pioneer funds will be the first ones to receive a GIIRS rating.

As impact investing becomes more defined as an industry and a common language for measuring and rating impact emerges, some big questions will have to be confronted.

The selection and definition of indicators is, inevitably, the result of a value judgment. For example, how does one rate results in healthcare: should treating a patient suffering from HIV/Aids receive a bet-



Self-empowerment schemes for women in Nairobi, Kenya

PHOTOS: AFP/GETTY IMAGES

IMPACT INVESTING: EXECUTIVE SUMMARY

BY NATHAN WILLIAMS AND
ALEX CARTER

For this report *This is Africa* surveyed a representative sample of European and US limited partners, including pension funds, insurance companies, endowments and state-backed funds. Conversations with these investors focused on five main areas:

- Exposure to emerging markets and sentiment towards these markets
- The attractiveness of Africa within emerging markets
- Understanding of socially responsible investment and the social impact of investments
- The relationship between socially responsible investing and investing for a financial return
- Knowledge of impact investing

It is clear from the findings of this report that emerging markets are now an accepted portfolio diversification tool. Around 65 percent of investors interviewed for this report have an allocation to emerging markets and over 50 percent expect to, or are considering increasing exposure.

What is also clear is that Africa is seen very much as an emerging markets outlier. Less than 30 percent of respondents target Africa-focused funds, and 38 percent of these invest in funds focused only on South Africa. Of those investors in our sample considering building exposure to emerging markets, sentiment on Africa is split; half expect to allocate money to Africa and half have no plans to do so.

With regards to SRI issues, there is a wide variance of understanding about its role and how it is best employed as part of an investment strategy.

61 percent of investors have no mechanism for reviewing the social impact of their investments. Only 39 percent of institutional investors interviewed for this report said they monitor the social impact of their investments. 60 percent of investors which claim to monitor the social impact of investments view SRI as little more than a tick-box exercise; a negative screening mechanism which simply excludes certain sectors and companies in which investment could be viewed as unethical.

Just 18 percent of investors have a policy of actively monitoring the positive social impact of their investments and there is no uniform standard by which these impacts are measured. The majority of these investors tend to be state-backed funds which use SRI as a tool to promote social change through an activist investment approach.

Of the fewer than 30 percent of investors yet to build an exposure to emerging markets, concerns are numerous. These limited partners have been deterred by issues relating to poor corporate governance, lack of transparency, corruption and political risk. In conversation, many of these investors accepted that a certain element of misconception may lie behind their reluctance to invest in emerging markets.

However, many stated that they would prefer to exercise greater caution in the name of responsibility than to invest when uncomfortable with the perceived level of risk.

The concept of impact investing was not widely understood by respondents, with only 32 percent having heard of it. As one might expect, funds investing on behalf of a state with a mandate to encourage social change have the greatest understanding of impact investing.

Outside these funds, knowledge was extremely limited and respondents were sceptical about the merits of such an approach. Investors complained about the data-poor environment and the inability to determine whether investing for a developmental or social return could also deliver benchmark financial returns. 25 percent said they would be prepared to accept a lower rate of return if they could see a proven social return on investments.

This report will detail the responses to interviews with limited partners and try to provide further insight into the varying degrees of understanding among investors. Identifying where gaps in knowledge exist and why they exist, as well as highlighting concerns from the investor community, we hope to further the debate about emerging markets and socially responsible investing.



PHOTO: BLOOMBERG/GETTY

REPORT FINDINGS: QUICK STATS

68%

Percentage of investors that maintain exposure to emerging markets

29%

Percentage of investors that maintain direct exposure to Africa

44%

Percentage of investors with direct exposure to Africa that are only present in South Africa

52%

Percentage of investors considering building exposure in emerging markets

26%

Percentage of investors considering building exposure in Africa

IMPACT INVESTING: THE REPORT

From 1990 to the beginning of this decade foreign direct investment into emerging markets grew at an average 23 percent per year, driven by the opening up of economies managed by the Soviet Union and the increasing liberalisation of Asian markets, not least in China. The 1990s were a record period for FDI globally, which peaked at \$1,400bn in 2000 and fell precipitously thereafter as economies slowed and M&A activity globally dried up. According to Standard & Poor's, FDI fell by nearly 40 percent in 2001 and hit a seven-year low of \$96bn in

2003. Each year since then has seen an improvement, with emerging markets at the fore of the post-2003 bounce back.

FDI inflows to emerging markets grew by 57 percent in 2004 and 26 percent in 2005, reaching a record high of almost \$400bn or more than 40 percent of the global total. FDI into developed markets fell away in 2007 and 2008, as the global financial crisis took hold and in 2009, for the first time ever, FDI into emerging markets, at 51.6 percent of the total global share, was higher than in developed countries, according to Ernst & Young.

ADDED-VALUE

Nearly 70 percent of limited partners declared an allocation to emerging markets. Over 50 percent expect to build on their current exposure.

The increasing appetite for emerging markets investment is reflected in our report, with nearly 70 percent of limited partners declaring an allocation to emerging markets and over 50 percent considering or expecting to build on their current exposure. If one spoke to an investor ten years ago, 'portfolio diversification' was usually cited as the main reason for a small emerging markets exposure. Today, many investors see emerging markets as a core part of their investment strategy, driven by the consistent returns these markets have generated.

One French pension fund manager said "we are gradually increasing our exposure to these markets. Look at returns over the past ten years; in many years they have matched or beaten [returns] on offer in the West. This is a trend we think will continue." The financial crisis, alongside recession and uncertainty in developed markets, has sharpened some investors focus on emerging markets. "As it becomes harder to get added-value out of developed markets you have to look elsewhere," said one Swedish pension fund manager.

From interviews for this report, the average percentage exposure to emerging markets is 12 percent. This is ahead of a Bank of America Merrill Lynch survey earlier this year looking at US institutional investors' allocations to emerging-markets equities, which found the average was between 3 percent and 5 percent.

Private equity funds are the most favoured way for investors to gain exposure to emerging markets, with 62 percent of respondents favouring private equity funds.

According to the Emerging Markets Private Equity Association, investment by private equity funds in emerging markets over the first six months of 2010 totalled

\$13bn, compared with \$8bn in the first half of 2009, a 55 percent increase. The research found that 402 deals were completed in H1 2010, up 44 percent from 280 last year. Brazil is fast becoming the most favoured investment destination among private equity firms, with the country seeing a 53 percent jump in investment from 2009 levels.

UPPING ALLOCATION

The average percentage exposure to emerging markets is 12 percent.

One US pension fund manager said his target was a 50 percent allocation to emerging markets. "We want to move away from a domestic-heavy portfolio and build exposure to around 50 percent of assets under management." He said they were now comfortable with the risk-return ratio in emerging markets and confident it would deliver returns in-line with or better than historical levels.

Fundraising levels for private equity have also risen in 2010 with \$11bn raised in the first half of this year against \$9bn in the first six months of 2009, EMPEA research indicates. Asian funds make up more than half of the total, the figures show, and one-third of total capital raised in emerging markets in the first half of this year went to China-dedicated funds.

AFRICA UNCERTAINTY

Less than 30 percent of respondents have exposure to Africa.

While investors are increasingly attracted to emerging market investment, Africa appears to sit outside the definition of an 'emerging market' for many investors. Less than 30 percent of respondents have exposure to Africa and of those, 45 percent invest in funds focused only on South Africa. Among investors in our sample there is little consensus on the prospects for the continent; half expect to allocate money to Africa and half have no plans to do so. A UK pension fund with investments in funds targeting emerging markets, when asked if they were considering gaining exposure to Africa said: "We are a cautious investor and Africa is too risky for us at present, but if political problems were resolved across the continent we would look again. It's a very big market with a wealth of

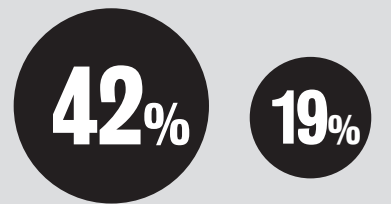
natural resources."

Uncertainty around political stability and the lack of transparency are concerns for investors who stated they have no intention of investing in Africa. "Corruption is a big problem. You need to have clarity about how you are going to get your money out once it's in," said a French insurance company manager. One UK pension fund asked, rhetorically: "State aid is pulling out of some countries so why would a pension fund go there?"

At a conference in London focused on investment in Africa, Patricia Dineen, managing director at US investment house Siguler Guff, listed a number of concerns. She said the firm had not invested in Africa to date because of worries over corruption, transparency and the rule of law. She also said the firm was not convinced there is enough deal flow or manager talent and exit opportunities are scarce. She voiced concerns that if things go wrong "are there enough like-minded limited partners in a fund that that can fight with us?"

Martin Poulsen at the African Development Bank conceded that "the environment is data-poor and there is a lack of transparency." He believes African investors can play an important role in encouraging foreign investment. He said that if more African pension funds were to invest in private equity funds targeting the continent it would "help foreign investors get comfortable in terms of due diligence". Responding to criticism that there is a lack of manager talent, Jasper Persson, senior investment officer at the European Investment Bank said investors should not apply the same criteria to emerging market managers as they do when selecting GPs in developed markets. "There

REPORT FINDINGS: QUICK STATS



Percentage of investors that monitor the social impact of their investments

Percentage of investors that do more than simply screen negative investments

is always a pool of fund managers that have a track record but limited partners need to look beyond that. Emerging markets are a fast-changing environment where track record may not be as valid. The key thing is to look at the quality of local teams."

SOUTH AFRICA

Of the 29 percent of investors with exposure to Africa, 45 percent invest in funds focused only on South Africa.

Some investors spoken to for this report view Africa not as one homogenous entity but a continent where investment risks can differ wildly from country to county. A pension fund manager in the UK said it was "wrong to regard Africa as one place. We are considering investing in funds focused on Morocco and South Africa where there is greater stability."

South Africa has been the primary beneficiary of foreign investment in sub-Saharan Africa over the past few years, claiming 39 percent of total FDI in 2009, around \$125m, ahead of Nigeria with 21 percent and \$69m, according to the United Nations Conference on Trade and Development.

This mirrors research for this report, which found that of the 30 percent of investors with exposure to Africa, 45 percent invest in funds focused only on South Africa. A Finnish pension fund investor said that "Africa is somewhere we are looking to expand to. The continent is undergoing a lot of change at the moment and sub-Saharan African in particular is somewhere we are currently looking at for investment opportunities."

"We are a cautious investor and Africa is too risky for us at present, but if political problems were resolved across the continent we would look again"



PHOTO: BLOOMBERG/GETTY

SOCIALLY RESPONSIBLE INVESTING

Only 39 percent of institutional investors interviewed for this report said they monitor the social impact of their investments.

The universe of funds catering to socially responsible investing has grown exponentially over the past decade. As concern about the potentially harmful consequence of investing in funds focused purely on making a financial return has grown, fund managers have reacted by creating products which offer investors a route towards a more ethical investment approach.

According to corporate social responsibility ratings agency Vigeo, the number of SRI retail funds in Europe increased to 879 from 683 in the 12 months to June 2010, while assets under management rose 41 percent to \$107bn from \$73bn. According to Eurosif, the European Sustainable Investment Forum, total assets under management in all SRI products now stand at around \$5,000bn. In Asia, the number of funds with an SRI investment remit passed 400 earlier this year, a massive 70 percent increase on May 2008 levels, according to research by website Ethical Markets.

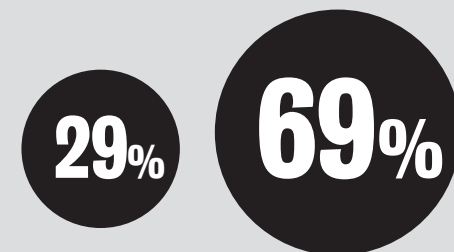
While the popularity of SRI products may be growing, only 39 percent of institutional investors interviewed for this report said they monitor the social impact of their investments. Of this percentage, the majority have a passive rather than active monitoring process, with 60 percent screening potential investments and excluding those deemed harmful or unethical. One Swedish pension fund manager said that his fund excludes investment in tobacco companies but has no other investment restrictions. The manager said that in his view this exclusion policy satisfied the SRI responsibilities of the fund.

ACTIVE MONITORING

Just 18 percent of investors have a policy of actively monitoring the positive social impact of their investments.

Just 18 percent of investors have a policy of actively monitoring the positive social impact of their investments and there is no uniform standard by which these impacts are measured. "One of the big problems is that investors have different understandings of what SRI is and how it

REPORT FINDINGS: QUICK STATS



Percentage of investors that have heard of impact investing

Percentage of investors that currently have a monitoring system and would also like to develop a greater understanding of the positive social impact of their investments

should inform investment strategy," said one investment manager at a state-backed investment fund.

Eurosif, the European Sustainable Investment Forum, a European lobbying, communications and research group, says that SRI "combines investors' financial objectives with their concerns about social, environmental, ethical and corporate governance issues. Some SRI investors refer only to the SEE risks while others refer to Environmental, Social, Governance." Some prefer not to focus on an acronym but prefer the term "sustainable investing". This range of terminology echoes the incoherent investment approach taken by investors.

In 2009 the German-based consultancy Funds@Work found that out of 56 Central European investors involved in screening social impact, 19 used different standards for their socially responsible investing - ranging from the Swiss Ethos Stiftung Charta to the United Nations Principles for Responsible Investment and the Eurosif transparency guidelines. 17 eschewed any agreed standard and defined investing according to their own rules.

Investors interviewed for this report which do measure the social impact of their investments use a range of standards, ranging from International Labour Organisation, UNPRI, the World Bank, the European Development Finance Institutions and OECD guidelines. The most comprehensive sovereign funds used a combination of all these standards. Many funds claimed not to adhere to a prescribed set of rules but analysed investments on a case-by-case basis and excluded investments deemed unethical.



PHOTO: BLOOMBERG/GETTY

SRI PERFORMANCE

60 percent of those who do take SRI considerations into account prefer a passive screening approach.

With no agreement on how to label these investments, it is hardly surprising that there is also no uniform standard for measuring the impact or performance from a social, environmental or developmental perspective.

This lack of a uniform performance measurement standard has deterred some institutional investors, with one London-based pension fund manager complaining that "there is no hard evidence that taking social investment criteria into account will lead to better returns".

Although lack of sufficient good quality performance information is a regular complaint from institutional investors, a number of papers have been published

which suggest that while SRI investing may not outperform traditional investment approaches, it does not underperform either. In September this year research group Edhec-Risk found that SRI funds do not outperform traditional funds. The group analysed returns from the best-performing green and SRI-labelled funds between January 2008 and December 2009 and found no added value in comparison to traditional funds, but also no under-performance.

"There is no hard evidence that taking social investment criteria into account will lead to better returns"

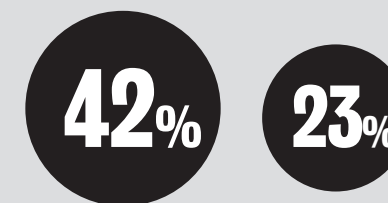
SOCIAL RETURNS SCEPTICISM

"Our fiduciary responsibility is to provide returns for members. We are not here to be philanthropic. That's someone else's job: government, charities and foundations."

Some investors do not believe it is possible to make attractive returns at the same time as promoting social development. "It is one thing to screen out unethical companies or sectors; it is another thing entirely to ask institutional investors to improve the lives of poor people and make good returns for pension fund members at the same time." This appears to be the over-riding sentiment of limited partners interviewed for this report, with 60 percent of those who do take SRI considerations into account preferring a passive screening approach.

Some argue it is not the role of institu-

REPORT FINDINGS: QUICK STATS



Percentage of investors that would be interested in developing a greater understanding of the positive social impact of their investments

Percentage of investors that would accept lower returns for proven social return

tional investors to think in anything other than commercial terms. "Our fiduciary responsibility is to provide returns for members. We are not here to be philanthropic. That's someone else's job: government, charities and foundations, such as the Bill and Melinda Gates Foundation," said one UK pension fund manager.

These views are echoed by another pension fund manager in the UK who said it was not appropriate to mix social issues with investment decisions. According to this manager of a large company pension fund, investment decisions "should be made on a rational basis and to mix politics and personal views on social issues [with investment decisions] can confuse those decisions."

A US pension fund manager had a similar view: "If a product happens to be an SRI asset and can deliver good returns we would consider investing, but we won't invest on moral grounds only."

A Danish pension fund manager said that the fund had considered investing in SRI products but decided against it "because it is lucrative and hard to find socially responsible funds" which can deliver a good return.

A pension fund manager in the UK said that the investment committee had looked at investing in SRI funds but had decided against it to avoid "limiting our returns". He comments on the dilemma facing funds which have yet to introduce even a screening process, arguing that "once a fund has decided to go down that route it is hard to decide where to stop". He gave tobacco products as an example, asking whether a fund which stops investing in tobacco manufacturers should also stop investing in supermarkets that sell cigarettes. ➡➡

INVESTING FOR SOCIAL RETURNS

24 percent of investors said they would be prepared to accept lower returns for a proven social impact.

State-backed funds are at the forefront of investing for a social return. At a conference in London recently, Tony Bakels at Dutch development bank FMO said that “there is a very strong and logical correlation between financial impact and developmental impact”. He argued that if a company is well run it will create more jobs and operate more productively, benefiting the wider local community while also generating good returns. Although targeting a commercial return, these funds are not set up to maximise returns and as a result have a more flexible investment mandate than many other investors.

An investment manager at the Danish sovereign fund, IFU, said that the fund will accept a lower rate of return where they can see money is supporting social development and improving infrastructure, but they are still a commercial body and need to make positive returns on investments. Jasper Persson at the European Investment Bank points out that financial and developmental aims can be complementary and is a useful part of an investment pitch. “The science behind SRI continues to evolve. We are always learning what to look for. It can help us tell a compelling story to stakeholders and other investors. Only when a business is profitable can it create jobs and when we generate profits we can take more risk and be developmental.”

PROVE IT WORKS

“The argument in favour of a social investment approach is persuasive, as a responsible investment approach is a long-term approach and that is more likely to deliver better returns.”

State-backed funds may be at the vanguard of social investing, but conversations with investors for this report suggest that profits will not always trump social considerations. Provided there was evidence to support the impact of a developmental approach, 24 percent of investors said they would be prepared to accept lower returns.

A manager at a Finnish pension fund said

PHOTO: BLOOMBERG/GETTY



that they do accept lower rates of return in some developing markets, and the return model they use assumes investments in developing markets will take longer to mature. He said: “We are comfortable having a longer investment horizon, but returns are obviously the ultimate goal and so we need to get [to a benchmark level] eventually.”

In many cases the move towards more responsible investment has been prompted by pressure from shareholders and the reputational risk attached to investing in a company or sector perceived as unethical. One UK pension fund manager said that the fund recently invested in an ethical vehicle “because of pressure from the members who wanted to be able to monitor the social impact their money was making.”

Others, however, worry that any move to take social criteria into account could harm returns and would not be perceived by the wider public as an acceptable trade-off. “I would be very careful with this approach. There has been a lot of bad press about poor pension fund returns and I don’t think people would accept it,” said the manager of a local council fund in the UK.

For many investors, lack of information remains the primary obstacle to a more socially-orientated investment approach. As one UK pension fund manager explained: “The argument in favour of a social investment approach is persuasive, as a responsible investment approach is a long-term approach and that is more likely to deliver better returns. The problem is finding statistics that demonstrate this works in practice. If there was a body of evidence, then that would have a huge impact on our strategy.”

STANDARDISATION

“Standardisation is absolutely essential for SRI to gain wider credibility within the investment community.”

A paucity of information from a sector in its relative infancy is to be expected; the more immediate problem is that accurate

“There is a very strong and logical correlation between financial impact and developmental impact”

REPORT FINDINGS: QUICK STATS

52%

Percentage of investors that do not engage in socially responsible investment products

23%

Average percentage of AUM engaged in emerging markets

performance figures depend, in large part, on a common criterion against which you can measure what good and bad performance might look like.

The chief investment officer at a Swedish pension fund said that “standardisation is absolutely essential for SRI to gain wider credibility within the investment community.” A UK-based pension fund manager placed the emphasis in the investor community “to do more to educate people about the financial benefits of SRI. If we can’t decide what it is, how are we going to convince people?”

In an interview with the *Financial Times* earlier this year, Rainer Jakubowski of BVV, a \$25.6bn pension fund for the financial services industry in Germany said: “a minimum standardisation would strongly facilitate investors’ orientation in the jungle of sustainable products” and make it a viable investment opportunity at last.

Tony Bakels at the FMO said: “Investors and investees see the benefit of ESG. Investors see it more and more as an integral part of their own investment strategy.” This may be true, but if the majority of investors continue to view ESG considerations on a passive basis by taking a binary approach which simply excludes investments, it will be difficult to make the case that a proactive approach can deliver good returns.

There is evidence that investors are moving towards a more active approach to monitoring. One large US pension fund investor stated that it is going to end negative screening procedures and replace them fully with a positive screening process, enabling them to pick out assets that will allow for the maximum “social or environmental return” to “financial return” ratio. ➔

THE CENTRAL ROLE OF INVESTORS

Corporate responsibility and the principles which underpin it are well-established in developed markets, but at a less advanced stage in many emerging markets. By definition, companies in emerging markets lag those in developed markets, but as these markets graduate to “emerged” status, improved infrastructure and governance should usher in greater transparency and disclosure on the part of companies and investors. Indeed, improved corporate governance and a focus on corporate responsibility should be a pre-requisite for a country or region wishing to label itself “developed”.

There is, however, nothing inevitable about this process. The danger, in fact, is that investors view emerging markets as good investment destinations because of their under-developed corporate governance structures, rather than in spite of them. Responsible investment practices in emerging markets will only be driven by pressure from investors, especially those in developed regions of the world.

More than 18 percent of investors will need to have a policy of active monitoring in place to improve performance data and encourage others to take a more engaged approach to SRI.

One pension fund manager in Norway who does actively monitor the social impact of its fund investments said: “Investors complain about not having good information, but it is up to them to commit to understanding more about socially responsible investment. Greater commitment, and more money [for these funds], is the only way we’ll get more robust performance data.”

“Investors complain about not having good information, but it is up to them to commit to understanding more about socially responsible investment”



PHOTO: CORBIS

CONCLUSIONS

Emerging markets have matured to the extent that they are now a central component of many limited partners’ investment strategies, with nearly 70 percent committed and 50 percent expecting to or considering building on this exposure. If the economic recovery in developed markets remains protracted, it is likely that investors will devote increasing amounts of time and money to emerging markets.

Africa is yet to benefit from this uptick in investor sentiment towards emerging markets, with only 29 percent of those surveyed having committed capital to funds investing in Africa. Many are discouraged by a lack of transparency and general uncertainty about the business and political environment. South Africa is the country which enjoys the greatest degree of confidence, with 44 percent of those with exposure to Africa investing only in South Africa. Tackling transparency issues and ensuring the proper infrastructure is in place would appear essential to boosting investor confidence and encouraging greater investment.

Investors are largely wedded to a passive approach to SRI and have yet to be convinced there is great merit in monitoring the social impact of investment. Few investors believe investing for a social impact can deliver returns comparable to traditional investment

styles and understanding of developmental impact is low. The main barrier to progress in this area appears to be the lack of, or perceived lack of, convincing data which measures the social impact of investments.

Just 18 percent of investors actively monitor the social impacts of their investors; for the majority of limited partners, returns are paramount. Although it is mildly encouraging that 23 percent said they would consider a lower rate of return for a proven social impact, most pointed to their fiduciary responsibility to maximise returns for investors. That said, only 29 percent had heard of impact investing and 42 percent are interested in developing a greater understanding or SRI and social impacts. This suggests that there are a substantial number of investors with the desire to contribute more fully in this area, given the resources.

Standardisation in the SRI space to enable investors to compare social impacts of different managers against common criteria would be a big step towards helping LPs make more informed investment decisions. However, investors themselves need to be at the forefront of this push for a standard regime. Furthering understanding in this area is likely to encourage greater investment.

The Rockefeller Foundation provided financial support for this research. The research was conducted independently by This is Africa and without input or influence from the funding body or any third party