"Impact Investing"

– A Profitable Philanthropy?

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CS. Amar Kakaria ACS, ACA, ACWA

Director, Fusion Advisors Pvt Ltd, Mumbai
amar@fusionadvisors.in

'Return on Investment' is the critical factor which is considered by most of the financial investors while putting in funds in new projects. However, a new breed of investors called 'Impact Investors' is getting active to support projects with social angle. These investors seek to put markets to work for millions of people around the globe – from the tenderloin to the slums of Mumbai - who struggle with hunger, homelessness, disease, and environmental degradation, Impact investing has become a hot topic among donors and financial investors.

Broadly defined, Impact Investing means providing capital to eligible projects which can generate social impact in such a way that also takes care of monetary returns. These returns may vary from the initial principal amount upward (or potentially downward) depending on the nature of the investment. Impact Investors have primarily made such investments because they realized that they have the potential of making more impact per unit invested in this manner instead of giving a donation.

Impact Investing offers an alternative to philanthropists who reject the notion that, investing for profit and giving money to a social cause, are two mutually exclusive objectives. Although Impact Investing could be categorized as a type of socially responsible investing it contrasts with negative screening, which focuses primarily on avoiding investments in bad or harmful companies. Instead, Impact Investors actively seek to capitalize businesses and funds that are part of a global solution.

So is Impact Investing limited to philanthropic investors? Not quite. A non-philanthropic profit-driven private investor views impact investment as a new asset class. Many impact Investments have very little correlation to the performance of the global markets. For instance, in many developing countries the majority of workforce operates in the informal or unorganized sector which is quite disconnected from the global marketplace. So, while global prices for fuel and food may affect them, much else about their life is unaffected. Therefore, businesses serving them are also often insulated from global trends. As a result, such investments can improve the overall performance of an investment portfolio.

Rapidly growing supply of capital is seeking placement in Impact Investments across geographies, sectors and asset classes with a wide range of return expectations. What binds these Impact Investors is the shared conviction that creative investments can play a crucial part in addressing social and environmental challenges while also generating returns. This investment interest is sparking the emergence of a new industry that operates in the largely unchartered area between philanthropy and singularly focused profit-maximization.

Entrance of social enterprises, has attracted some level of attention from Angel Investors and Venture Capitalists (VCs) in the space. But 'Social Investing' still being an evolving asset class and investors have followed a fairly risk averse approach i.e. they are likely to invest in companies who have displayed proof of concept or proof of market. Early stage Impact Investors are investors who have realized this problem of the funding gap and are willing to take higher risk than VCs. These investors are open for assuming the market risk, technology risk and many-a-times business model risk.

It is with the support of such investors that social enterprises can actually move to the next level and begin to make an impact. These investors not only provide investment but also non-financial support that adds tremendous value to these enterprises such as developing strategic partnerships, scaling-up to new markets and regions, hiring talent etc. The entry of these new early stage impact investors in the Indian market augurs well for the social entrepreneurship sector. However, since the concept is relatively new and the first investments are yet to bear fruit, Impact Investing is still difficult to sell as a proposition for funds.

According to a recent study by the Planning Commission of India, investments by these funds have crossed Rs 1,200 crores in the following 17 funds that operate in this sector:

1) Aavishkar
2) Accion
3) Acumen
4) Bellwether (Caspian Advisors)
5) BlueOrchard Group
6) Creation Investments
7) Dia Vikas Capital
8) Elevar
9) Grassroots
10) Incofin
11) India Financial Inclusion Fund
12) Intl Finance Corporation
13) Lok Capital
14) Michael & Susan Dell Foundation
15) Omidyar Network
16) SONG
17) Unitus

A report by J.P. Morgan, Rockfeller Foundation and the Global Impact Investing Network (GIIN) made waves simultaneously in the worlds of social change and investment in 2010. The report estimated that potential profit for Impact Investors across just five sub-sectors of inclusive business could range from between $183 billion and $667 billion over the next ten years, with invested capital ranging from between $400 billion and $1 trillion. It is also predicted that in the next 10 years, high net worth investors would allocate 10 per cent of their portfolio to such investments, while institutions would allocate around five per cent. This report characterized the Impact Investing field as 'in its infancy and growing'. Further the sector is still to make up its mind about the relationship between returns and social impact, especially on whether sacrificing one will improve the other. While some investors, especially family foundations and charities, are ready to settle for a lower IRR (internal rate of return), provided they achieve the desired impact, others are aiming at achieving commercial IRRs with impact icing it.

Potential investors need to realize that Impact Investing will require significant due diligence and attention to measuring results, and till the field emerges, traditional philanthropic contributions will continue to be necessity. It is aptly said that:

"If you move your focus from profit computation to social contribution, life automatically becomes a celebration for everyone."

Words worth Millions

It doesn't matter how many resources we have. If we don't know how to use them, they will never be enough!