Impact investing : From 'Why' to 'Why not'

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Impact investing :The perspective

The whole idea of the investment in the 20th century was based on risk and return. However, gradually the modern ideas have evolved. The new model of investment is based on risk, return and impact. Impact investing is the investment made considering both the financial and non-financial factors. The non-financial factors refer to the environmental and social factors of the investment. Impact 'Investing' is fast growing new approach to economic development. Impact investing (II) aims to achieve positive social and environmental impact and create blended value through sustainable value propositions.

Increasingly, investors are wanting their financial investments / assets to reflect their personal values and have a positive impact on the world around them. At the same time, most investors still want to earn a reasonable return on their portfolio. "Impact investing" seeks to reconcile these two objectives by helping investors create diversified portfolios that strive to deliver competitive performance while generating measurable social and environmental impact. With appropriate investment planning and knowledge, investors can incorporate impact investing into their investment strategies without compromising their long-term goals.

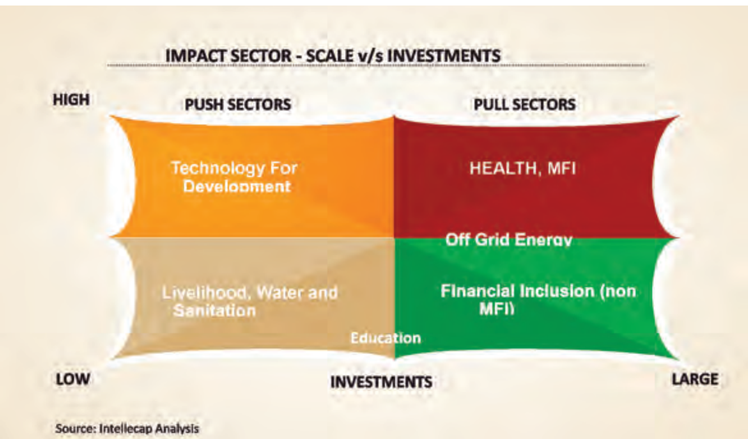
Impact investors intentionally and explicitly seek the dual objective of producing both financial and social/ environmental returns. This is a significant move away from both traditional business (that only focuses on maximizing financial gains) and from traditional philanthropy (that involves grant making with no expectation of returns). The rise of impact investing has been a timely response to several increasing uncertainties facing the world climate change, youth unemployment, poverty, steep economic inequality, lack of accessibility to water, basic education or healthcare, and the lack of absolute economic progress (that is leading to the rise of populism and the dismantling of institutions of liberal democracy), and the need for sustainable, impactful businesses are amongst several issues that require immediate and collaborative action. Impact investing therefore lies on a spectrum of investment philosophy upon which investors invest with the dual goals of both profit and impact.

The genesis

The social sector has been historically grant funded. This means that based on the impact and social work that the entrepreneurs perform, philanthropic individuals have been giving them money and support, often not expecting any returns other than just evidence of the good work. This sort of funding has been extremely beneficial in areas where commercial models are challenging or the solutions are risky and require a high degree of experimentation or innovation. Over the past few years, probably since the late nineties, there has been a tacit understanding that in some cases 'grant' or 'free' funds might not be the best way to have a social impact and might not be able to create a growth-based ecosystem. This realization might have also come from the lack of sustainable results and a high amount of pilferage that some social organizations have unfortunately shown. Also, the argument has been that the 'social' mindset and 'free funds' have also retarded professional behavior and innovation often leading to heavy wastage and high resource drain. Finally the recessions in the recent years and the drying up of grant funding sources have also reduced the popularity of pure philanthropic capital as many large donors have been forced to reduce their development spending significantly. From all this 'a new class of investors' has emerged who, while looking to make a social impact with their funds, also look for financial returns (or at least a return on capital). This group has coined themselves 'Impact Investors' and over the past five years, have mushroomed in every country and sector that earlier was grant funded or regarded as social.

Types of Impact investors

Impact investors often are one of two types: "financial first" or "impact first." The former seeks to optimize financial return while requiring some measure of social and environmental impact (usually by targeting risk-adjusted returns), while the latter seeks to optimize social and environmental impact with a financial floor, willing to accept a higher risk or below market returns in order to create some social good. However, impact investors increasingly reject these types of distinctions, as reflected in an investor survey in 2018. Sixty percent of investor respondents did not believe that a trade off between impact and financial returns is necessary.



The practice of impact investing involves three core characteristics:

- Intentionality - an investor's intention to have a positive social or environmental impact through investments
- Expectation of return - the investment is expected to generate a financial return on capital or, at minimum, a return of capital
- Impact measurement - a commitment by the investee to measure and report on the social or environmental performance and the progress of underlying investments, ensuring transparency and accountability

Impact investing directs capital to enterprises that generate social or environmental benefits. Impact investment is an investment made in an organization that offers a market-based insight to a social or environmental challenge that the investor is willing to address. This definition revolves around intent of the investors. So, the impact investment is something chosen at investors discretion because of its ability to generate the particular social or environmental returns of interest to that investor

Investors have always looked to effect social changes through market powers. It was either done on the strategy based on Social Responsibility Investing (SRI) or via Environmental and social governance (ESG).SRI segregated itself from the traditional way of investment by bringing in the sustainability factors like social factors, governance, or ESG in short. Impact investing brought significant shift to this approach. Impact investing is seen as improvement over Social Responsibility Investing. It mainly looks to create the positive side rather than negating or minimizing the negative side effects. The social and environment factors not only serve as lenses but in impact investing, they lie at the forefront for any decision-making criteria by the investors.

Impact investing for blended value

The idea behind impact investing is that investors can pursue financial returns while also intentionally addressing social and environmental challenges. this simplicity, or perhaps because of it, the concept can be threatening to some people. Many mainstream investors reject the idea that they should pay attention to the social impact of their investing, insisting such considerations are the domain of governments and charities. However, impact investing is not a modern aberration. The idea that our investment decisions can impact the wider world beyond generating financial returns did not begin when we first described "blended value" in 2000, or when we convened the group that coined the phrase "impact investing" seven years later. In many ways, it reconnects with a centuries-old tradition that held the wealthy responsible for the welfare of the broader community. What is new is that impact investors are profoundly optimistic about the role business can play in advancing the common good and the leverage social enterprises can achieve by employing financial tools. We see business practices as a powerful force that can be harnessed for good, rather than a necessary evil that must be curtailed.

Who are Impact investors

Impact Investors categories in India and abroad include : High Net-worth Individuals, Foundations and charities; Banks; Impact funds including pension funds, sovereign wealth, and social venture funds; CSR pooling vehicles; CSR funding by companies; Angel investors; Funding platforms or exchanges like the Impact Investment Exchange based out of Singapore.

Growth of Impact investing

Impact investing is relatively a new concept and its dimension is only increasing in various sectors. Through its impact in various sectors, it tries to uplift the societal and environmental impact. Impact investing is the investment made across many asset, classes, sectors and regions. The impact investing sector has grown into a significant market internationally. The development of the sector around the world has been driven by the recognition that philanthropic and public funds are insufficient to address the scale of social and environmental challenges facing the world today.As per the GIIN recently published report on Sizing the Impact Investing Market, as of 1st April, 2019, the estimated the current size of the global impact investing market to be $502 billion.Impact investing generally comprises of the private equity and some speciality bonds like the green bond. Recent statistics shows that impact investing is growing rapidly as investors are looking for the ways to generate benefits for society and expecting financial return. Impact investing related activity are increasing and almost growing exponentially. The demand for investment is ever on rise and therefore the regulators are coming in the picture. Investment was done in Impact investing from the foundation and pension funds as US government has made amendments that capital can be used for impact investing from foundation and pension fund. The only things investors are asking for greater transparency and better ways to measure impact. The flow of capital is increasing but its nature is quite diverse as even the three sectors-housing, energy, and microfinance, constitute only half the total investments.

Challenges:

One might come across various challenges while measuring social or environmental impact of impact investing.

Diversity: Investment preference is quite diverse and heterogeneous. There exist diversified preferences be it intent of the investors, sectors, mission and the vision. Because the investment is quite diversified across the sectors with different intent and vision, it makes measuring impact difficult as it requires many different indicators.

Standardization: To come up at any investment decision, investors would like various outcomes compared on similar parameters. The measures should be comparable and at the same time be also consistent. However, standardization in case of impact investing is not feasible as nature and complexity of investment in a particular project might not be captured in one number owing to diverse nature of impact investing.

Capacity and cost: Data collection is the first and foremost step to assess measurement of anything. Measuring the impact investing outcomes in society and environmental factors is a a challenge as this is a new market with hardly any research conducted before. Thus, extensive data collection and analysis could be costly and time consuming as well.

Way forward for impact investing

Many investors have employed a wait-and-see approach when it comes to impact investing, questioning whether this is a fleeting fad or has staying power. As the space continues to evolve and as success stories continue to surface, the risks associated with investing in marginalized communities or "sustainable" products will diminish in turn. Indeed, there is mounting evidence that not only are financial and social returns not fundamentally in conflict, but also that they can align to simultaneously generate competitive returns for investors and a positive impact for society.

Any change in society erupts from change or shift in society wide thinking. There is a need of global movement for impact investing which stresses on the existing financial system to unleash the societal and environmental factors alongside making financial return. Having impact investment products and hoping the impact investors invest in them is only a short-term remedy. Everyone should realize and must be empowered that their capital and efficient investment can lead to better world. There must be end investors demanding for access to impact options for their savings and pensions. Though it is not easy but to have a new financial system based on impact investing is certainly possible. It requires lot of efforts and energy from so many people. The new financial system will safeguard and value environmental factors, society and lives. The new financial system based on impact investing will enrich our lives.