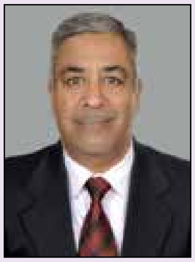

Social Finance - Finance for the Future

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The perspective

Global environmental, social, and governance (ESG) trends are rapidly reshaping the economy and presenting significant risks and opportunities for investors. By 2050, the population is expected to grow by more than 30 percent, to more than 9.5 billion people, with the majority of this growth happening in urban areas in the developing world. Meeting the needs of this population in an increasingly resource-constrained world will require tens of trillions of dollars in investment. This also presents compelling business growth and investment opportunities for investors in many new markets and sectors. Resource scarcity, climate-related impacts, global health dangers, social instability, and substantial demographic changes already are presenting business leaders with issues and influencing decision making that will determine future business success and investment performance. More investors recognize the importance of these global trends to their investment decisions and are adjusting their asset allocation and investment-management strategies accordingly.

What is Social Finance

Not too long ago, the notion of generating social good along with financial returns was considered a fringe idea by most investors. But recently the area of "social finance" has started to enter the mainstream and receive consideration from Wall Street giants and some of the world's largest institutional investors. Social finance is an approach to managing money which delivers a social dividend and an economic return. Social finance is often used to describe the lending and investment into companies who consider themselves social enterprises, charities, co-operatives, and other impact-focused organizations. The term can include community investing, microfinance, investing in socially-responsible and sustainable businesses, social impact bonds, and social enterprise lending. Outcome-based philanthropic grant making and program-related investments, sometimes referred to as venture philanthropy, also fall under the umbrella of social finance. Social finance is an approach to managing investments that generate financial returns while including measurable positive social and environmental impact. Social finance includes a full range of investment strategies and solutions across asset classes that can provide an array of risk-adjusted returns tailored to investor intent. Social finance is a tool that seeks to mobilize private capital for the public good. It creates opportunities for investors to finance projects that benefit society and for community organizations to access new sources of funds.

Social finance investments

- involve access to capital that has a positive impact not only financially but also on society as a whole;
- can be made by different types of investors. These include charitable foundations, retail investors, banks, governments and institutional investors such as pension funds;
- can be made to a variety of organizations that seek to have a positive impact in their communities
- can be made using a variety of financial tools, including loans, community bonds, equity investments and social impact bonds;

Finance for social good

What is social finance? Rachel Kalbfleisch of the International Development Research Centre (IDRC) defines it as a collection of approaches to managing money that create value for society or the environment, often while producing a financial return, while the MaRS Centre for Impact Investing calls it "an approach to managing money to solve societal challenges". In other words, social finance is a movement that covers various ways of using finance-via socially responsible investments, micro-loans, community investments, and so on-to achieve a social or environmental impact. Social impact investing is commonly used to describe the direction of investment funds to opportunities or companies that have desirable environmental, governance or social factors (also called ESG investing), and is related to social finance, which involves the use financial assets or instruments to fund projects that have a positive social or environmental impact.

Social Finance: Where Wealth and Values Meet

Investors who adopt social finance strategies don't have to sacrifice returns in order to feel good about the makeup of their portfolios or to effect meaningful societal change. The term "social finance" means different things to different people. Often, those words bring to mind the avoidance of so-called "sin stocks" - shares of companies involved in the manufacture or distribution of tobacco or alcohol, or shares of gambling enterprises. But the term encompasses much more. Social finance offers investors ways to realize competitive returns through investments designed to achieve meaningful societal or environmental impact. Investing in socially and environmentally conscious ways is growing in popularity with all types of investors

Key Trends in Social Finance Activity

Much has been written about the evolution of social finance, from the early days of socially conscious investing aligned with religious values, and, later, to the use of social finance as a tool to eliminate racial discrimination and apartheid in South Africa. This focus on values and ethics has promoted the growth of strategies such as negative screening, which uses ESG factors as a basis to exclude sectors, countries, or practices from portfolios or funds. Today, the SRI world has moved from a practice of negative screening and exclusion to one of seeking or encouraging certain characteristics in portfolio companies. Social finance today offers a wide range of options aligned with different risk appetites, return expectations, liquidity needs, and investors' expectations of impact. Today Social finance has grown significantly over the past decade, with strategies and products across asset classes aligned with different investor needs, motivations, and return expectations. Estimates show that social finance activity today is valued at upward of US$22 trillion, and many strategies have the potential for double-digit growth in the near future. The diverse motivations and trends in social finance activity for some mainstream investor groups is helping drive this growth and diversity in investment opportunities.

Scaling social finance

Despite rising interest in the sector, some investors say the social finance market's development has been held back partly by a lack of suitable products to invest in, confusion surrounding the proliferation of industry terminology and questions of whether or not investments can be profitable given their limited track record. This has left many mainstream investors hesitant to dip their toe in the space.

To address these challenges, the social finance sector must come up with better ways to measure non-financial metrics, increase transparency of social and environmental impacts on financial performance and create a wider variety of investment products, growing investor interest in social finance into considerable capital allocation will necessitate systemic changes to the current system. This includes not only improving products to meet investor goals and performance expectations, but also strengthening the enabling ecosystem, including the infrastructure, skills, and incentives that shape business decisions and are needed to execute transactions. This requires a collective effort by the investor community to overcome key challenges and dismantle barriers to entry for mainstream investors in social finance. Investors themselves have an important role in this. They have a number of levers at their disposal, including large amounts of investment capital, the ability to partner with and engage policymakers, deep technical expertise, and the opportunity to exercise sector wide coalition-building power.

The following are the imperatives and drivers of social finance

- Facilitate asset allocation across multiple social finance strategies that cater to varying risk appetites and return expectations.
- Codesign products with established return expectations and clear impact objectives for easier adoption.
- Deepen social finance expertise and knowledge across the investment value chain, particularly among advisory and investment teams.
- Develop and adopt standardized nonfinancial metrics across investment activities. " Integrate social and environmental impact into valuation and pricing of risk.
- Drive consistent and material disclosure of social and environmental impacts on financial performance and impacts on shareholders.
- Share best practices on the integration of social finance into portfolios with stakeholders, peers, and other beneficiaries to promote learning and increase awareness.
- Participate in industry dialogues to clarify and reinforce the interpretation of fiduciary duty to include ESG factors.
- Align internal and external incentives with long-term value and encourage good governance and positive policies that can respond to and support broader uptake of social finance.
- Provide guidance and technical assistance to strengthen the pipeline of investment opportunities for both investors and intermediaries.

Measure for Measure

Almost everyone (with good intentions) hopes to achieve positive social impact. The notion of the social impact of business has become so mainstream that government at the highest levels-including G8 leaders and even the Pope-advocate the creation of institutions to give greater attention to driving social impact". However, one of the most difficult challenges facing social finance revolves around the question: how do we measure social impact? There are, in fact, many ways to measure it, but the crucial question concerns how to consolidate these many methods under one impact measurement and evaluation system. At present, the impact measurement field is quite chaotic: each institution or region typically has its own assessment criteria for impact, and creates its own metrics. Though in recent decades the Global Impact Investing Network (GIIN) and Social Value UK (formerly the SROI Network) have made efforts to consolidate their metrics, there has not been a single governing authority to establish an official and centralised system of impact measurement and evaluation.

The promise of impact investing in India

Achieving the ambitious sustainable development goals (SDGs) by 2030 will take an estimated $5 to $7 trillion per year, with a financing gap of $2.5 trillion in developing countries. In India alone, the outsize challenge has been translated into a financing gap of $565 billion. While the country has seen huge progress across the social sectors, enormous challenges remain. Closing this gap requires action on several fronts; efficient and effective domestic resource mobilisation, outcome-focused donor efforts to ensure that money is spent well and harnessing private capital for good. In recent years, interest has grown globally amongst governments and markets to develop new investment approaches, such as impact investing or purpose-driven finance. Impact investment refers to the provision of finance to organisations with explicit expectations of financial returns as well as measurable social outcomes.

Conclusion: Looking Ahead

Going forward, social finance faces a broad set of opportunities and challenges. Ellie Howard of Cicero Group suggests that "in time, social finance will become inherent to the practice of investing in line with the progression to a conscious economy", but that "the sector first needs to establish itself".21 In other words, what is now somewhat of a fringe concept-investing to achieve measurable social impact-will eventually become inextricable from "plain-old" normal investing. When that happens, we'll have an economy that includes social impact in its core calculus; that incorporates more of the full costs and benefits of doing business; and that is more "conscious" of the impacts it has. to integrate social finance into investment decisions it is necessary to help asset managers, advisors, and intermediaries communicate the options and benefits of social finance more clearly, and in ways that resonate with investors. ■