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# Social Impact Investing Discussion Paper

February 2017

When you
think with a
global mind
problems
get smaller

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**Social Impact Investing Discussion Paper**

Coffey would like to thank the Australian Government and the Treasury for the discussion paper on facilitating the growth of the Australian social impact investing market.

Based on our experience in the Indo-Pacific region, Coffey would like to offer four ideas to the panel to consider in exploring how the Australian Government can develop the social impact investing market both in Australia and overseas:

1. Use social impact investing as a tool for the Australian Government to support inclusive economic growth.
2. Promote a gender lens on investing.
3. Incentivise new private sector capital.
4. Use public data to get better investments and to generate measurable outcomes.

The attached paper elaborates further on these ideas.

For four decades, Coffey's international development team has devised solutions to numerous international development challenges. In Australia, Europe, Africa, the Americas and Asia-Pacific, we work every day with our clients in government and public and private sectors to help them achieve effective development outcomes. Coffey is part of Tetra Tech, a company with more than 16,000 employees and 400 offices worldwide, and an annual revenue of USD2.6 billion (FY 2016).

As part of our core business managing technical assistance globally for programs funded by Australia's Department of Foreign Affairs and Trade (DFAT) and the private sector, Coffey works with social enterprises and small-medium enterprises across the Pacific. We do the same for other donors, including United Kingdom's Department for International Development (DFID), United States Agency for International Development (USAID) and the World Bank. Our approach is to leverage from networks and identify social enterprises to create interest from new investors. We manage incubator and accelerator programs to link operators and innovators. We work with investors and intermediaries using a number of strategies to support social enterprises, including the blending of philanthropy and patient capital with investors seeking a return.

In the Pacific, Coffey is currently working with a number of partners including investors, Australian Business Volunteers (ABV) and the Criterion Institute - a US-based think tank specialising in gender lens investing—in order to deliver impact investment solutions for DFAT. In our submission, we have drawn from our work in the region and globally. We have outlined a little about Coffey, our experience with, and understanding why investors invest in impact, and the importance of gender lens investing and from this we have outlined four ideas for the panel to consider.

Yours faithfully,

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General Manager – International Development (Asia Pacific)

# About Coffey

Coffey International Development (Coffey) has a long history of working in the Indo-Pacific region, working with the Australian Government to deliver its aid program, and with national governments to implement new policy and direction. Coffey has considerable experience globally supporting the partnership between the private sector and public sector in development and the important role that financial investment can play in building local capacity.

Coffey's international development team is an implementing partner for governments and the private sector, relied on for more than four decades by our clients—including the Australian Government—to successfully deliver their programs in partnerships with local organisations, through our global network of development professionals. Today, Coffey is part of a global network of Tetra Tech companies that employs 16,000 people across 400 offices.

Examples of development programs where Coffey has supported through impact investment in developing countries include:

- Managing the **Ecosystem Accelerator Innovation Fund,** funded by UK's Department for International Development, launched in September 2016 and aims to bridge the gap between operators and innovators by enabling strong partnerships that support the growth of commercially sustainable mobile products and services.
- Managing **Pacific RISE,** funded by Australia's Department of Foreign Affairs and Trade, is working with investors, intermediaries and social enterprises to identify actual investment opportunities in Pacific businesses and connecting these businesses to capital. Pacific RISE uses gender lens investing as a tool to improve investment decision making and get more investment into businesses that have a positive impact on women.
- Third party monitoring and evaluation of **SPRING,** a business accelerator grants program funded by UK's Department for International Development and the Nike Foundation, that is supporting enterprises to develop products and services which could transform the lives of adolescent girls.
- Partnering with organisations to deliver innovative solutions including:
    - the **Miller Center's Global Social Benefit Institute (GSBI)** with combined experience of supporting enterprises with a focus on women's economic development and solving issues of poverty and social inequality
    - the Silicon Valley incubator, **African Technology Foundation**, bringing tech-expertise to provide African technology start-ups with the necessary knowledge, tools and investment opportunities to build the economic profiles of their respective communities; and
    - **Impact Hub** who run multiple programs for start-ups across the world.

Based on our insights and field experience, we have developed the following considerations for the Treasury to consider as part of their review. We welcome the discussion on social impact investing in Australia and look forward to continuing our support to this industry.

# Why investors are impact investing?

The growing impact investment market provides capital to address the world's most pressing challenges in sectors such as sustainable agriculture, renewable energy, conservation, microfinance, and affordable and accessible basic services including housing, healthcare, and education.[1] The impact investing market offers diverse and viable opportunities for investors to advance social and environmental solutions through investments that also produce financial returns.

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1 https://thegiin.org/impact-investing/need-to-know/

Impact investment offers the potential to invest in new models. Developing countries are seeing the growth of populations and a rising small to medium enterprise (SME) sector provides an opportunity to use social impact investment to achieve strong financial returns and social benefits.

Impact investment provides diversification and risk-mitigation for investors. Global markets are now more connected and financial shocks can have large impacts across traditional investments. Investing in developing countries and new industries has the potential to improve diversification.

Finally people, in particular young people, are thinking about the social impact of their decision making. This affects their consumption, resulting in a rise in value of fair-trade products and ethical fashion; their choice of workplace including employer's corporate social responsibility and volunteering opportunities; and also their investment choices.

Impact investment has developed because investors are interested in social outcomes, but there are also good financial reasons behind it. Impact Investing Australia's 2016 Investors' Report[2] found 123 Australian 'impact investors' of varying size with an investment portfolio of AUD333 million. Globally, the Global Impact Investing Network (GIIN) estimates that there are USD60 billion impact investment assets under management. Institutions primarily dominate impact investment although specialised social impact funds, gender-based funds, foundations and philanthropists are also investing in growth areas relating to children, issues affecting young people and clean energy.

Capital is provided in several forms including secured loans, unsecured loans, social or development impact bonds, quasi-equity and equity. It is often partnered with direct grants in the early stages of enterprise development, however there is an ongoing role for philanthropy to enable blended returns to investors. Institutional investors have a fiduciary duty to deliver market returns to their shareholders and to enable their participation, philanthropic foundations and trusts may co-invest and take a sub-market return.

Investors regularly claim there are insufficient social impact products in which to invest given the size of the market and they are interested in anything that fits their return profile. Consequently, there are many opportunities to consider.

**What does a vibrant impact investment industry look like?**

- New social enterprises are established and sustained, including new businesses led by women
- Social enterprises are able to access investment, reducing dependency on grants as a percentage of their revenue
- Social enterprises are supported by intermediaries to become investment-ready
- New investments are being made
- Intermediaries identify existing businesses that could be made investment-ready
- Intermediaries identify market opportunities that lend themselves to social enterprise
- Intermediaries have the capacity to apply a gender lens to investment and identify market opportunities that improve outcomes for women
- Social procurement contracts are being put in place
- Local employment and local economic activity is increasing in targeted locations
- Incentives for and access to markets for social enterprises is improving in targeted locations
- More funds and market makers are actively entering the market
- Impact investing is recognised and preferred as a business development option
- Investing with a gender lens is seen as a benefit to investors and intermediaries, leading to stronger investments, advantageous partnerships and expanded impacts.

2 Dembek, Madhavan, Michaus & Potter, (2016) 2016 Investor Report, Impact Investing Australia

# Role of the Australian Government to support social impact investment

The Australian Government is looking at ways it can create an enabling environment for the social impact investment industry in Australia as a funder and a regulator. Coffey would like to offer four ideas to the panel to consider in exploring how the Australian Government can develop the social impact investing market both in Australia and overseas.

## 1. Use social impact investment as a tool for the Australian Government to support inclusive economic growth

Impact investment supports developing economies in ways that are complementary to grants, and serves to build the local economy. Impact investment can generate employment, income generation, develop business capacity, improve local tax base and create links between Australian businesses and export. Investment also unlocks capital for the target economy creating business investment and enabling businesses to access global capital markets. Investment can support businesses to become more independent whereas grants have in some cases led to grant dependency.

The Australian Government through the Department of Foreign Affairs and Trade (DFAT) has launched a number of new initiatives to build the impact investment market in the Indo-Pacific Region.

**Designing new development programs that support impact investment in our region**

Supporting and promoting impact investment markets in our region is an effective way for the Australian Government to use part of the aid budget to work with the private sector and uncover new sources of capital. It is a tangible way for Australia to make our region more secure and at the same time establish new trade opportunities for Australia and its neighbours.

Increasingly we are seeing donors try a variety of different approaches to working with the private sector. By using investment, grants and technical assistance in combination, private sector development can be much more adaptable and powerful. Donors are increasingly moving away from the traditional grants style of providing relatively large grants to few enterprises and instead are mimicking investors and putting in small grants in a larger number of enterprises, while ensuring the investments show good social impact, potential for sustainability, have access to additional funding to scale and draw in non-government funding. This reduces reliance on grants and opens up new forms of investment opportunity for business.

In designing new initiatives, it is important for program design to understand why a market in our region is underinvested and design an approach based on this. It may be related to risk or it may be due to the limited visibility of investors to the market (such as is the case in the Pacific).

An example of where DFAT has invested is in Pacific RISE, an impact investment readiness fund which is a useful way for government or investors to support the pipeline of social enterprises and to increase the visibility of the market. Coffey has partnered with Australian Business Volunteers to manage Pacific RISE. Pacific RISE will assist Pacific social enterprises in accessing impact investment funding. Through Pacific RISE, Coffey develops the pipeline for investment through:

- identifying Pacific **social enterprises** interested in growing their business
- partnering with **intermediaries** to develop relationships in the Pacific by providing contacts and introductions, skill development particularly in gender lens investing and providing grant funds
- understanding **investor** needs, identifying those that align with the goals of Pacific RISE and identifying how we can better develop deals to fit their investment goals.

In addition, the design and implementation of programs in the Pacific can have relevant lessons for programs supporting indigenous communities and their development. While it is early stages, initial lessons include 1) placing culture and beliefs at the centre of any intervention and building from this, 2) identifying and supporting social enterprises in remote areas and 3) incentivising 'the right' intermediaries to help bridge the gap between enterprises and investors.

## 2. Promote a gender lens on investing

### What is gender lens investing?

The practices of gender lens investing goes beyond counting the number of women and girls served or working with female-led companies. It creates a framework to incorporate gender analysis into financial analysis to deliver better investments.[3]

Impact investing products and services often target women and girls as customers, but this does not mean that investors applied gender analysis through the investment process and this can turn women from an opportunity into an issues area. It may leave unexamined business questions affected by gender, such as who was involved in the product design process, who controls distribution or how are impacts or unintended consequences measured. Gender has most often been an explicit consideration when products focused on gender-specific activities, rather than considering how gender can impact on the design of universal products, such as mental health services or mobile phone technologies.

Gender lens investing creates better investments by having better data on which to base decisions. Gender lens investing has been driven by investors and the changing demographic of wealth holders, particularly in developed countries.

> *Globally, women's economic power is soaring. Women make 80 percent[4] of all buying decisions around the world. In the US, women by themselves are, in effect, the largest national economy on earth. Larger than the entire Japanese economy. Women control 51.3 percent of the private wealth in the United States and this is increasing. It is estimated that two thirds of private wealth equating to $22 trillion in the US will be in the hands of women by 2025. Women are inheriting family wealth by living longer than men, sitting equally on boards of family offices and becoming wealth holders in their own right through earning higher incomes.*
>
> *Many global banks and investment houses have already figured out that they need to work better to build relationships with women wealth holders and have put in place specific gender lens investing policies and products targeting women. Credit Suisse, Morgan Stanley, Barclays, UBS and Bloomberg have all launched new research, products and or funds with a gender lens.*
>
> - Understanding the Increasing Affluence of Women, Judith E. Nichols, Ph.D., CFRE

Investment funds can build strategies to incorporate gender awareness. These include ensuring capital is appropriate and available to enterprises owned by women, focusing on the benefits to an enterprise and the community, workplace equity and employment opportunities for women and prioritising investments in companies that have products and services that benefit women and girls.

While investors should not see themselves as sacrificing returns to invest with a gender lens, they may need to shift assumptions about how to value an enterprise and adjust the terms of the investment. For example, women are more likely to build normal-growth companies that grow one revenue stream at a time, such as service companies in informal markets. These companies are often lower-risk and more stable over time. The typical impact investor is investing equity, but debt is more appropriate for normal-growth companies. In this case, the gender-lens investor would shift the tool and the terms of capital to reflect the opportunity.

3 Anderson, Joy and Miles, Catherine (2015), The State of the Field of Gender Lens Investing: A review and a roadmap, Criterion Institute, October 2015

4 http://www.supportingadvancement.com/vendors/canadian_fundraiser/articles/womens_affluence.htm

Investors may also need to re-think the way they use data to measure risk and return. Without thinking about gender patterns and collecting sex-disaggregated data, finance might overvalue, undervalue, or miss certain data points, or there may be gender bias in the analysis or in the interpretation of the data that lead to poorly timed or poorly directed investments.

**Using gender lens investing**

DFAT has a target that 80 per cent of its investments have to affect women's economic empowerment. Gender lens investing is an important way that donors can turn a focus on women's economic empowerment for impact investment and as noted above, gender lens investing is driven by the investment community so this is a common ground.

In Pacific RISE Coffey—with support from the Criterion Institute, a US-based think tank working in the field of gender lens investing—wrote gender into the entire program design, not just the intended impact but how the program is structured, the implementation processes, structures and strategies to get to deeper and more durable social change.

For example[5], Pacific RISE engages with partner organisations such as intermediaries. We developed a baseline understanding of intermediaries knowledge of gender lens investing, and where they wanted more support. Into the program, we designed specific gender lens training, mandated gender lens questions in the application forms and selection criteria (we assigned 20 per cent of the assessment criteria to addressing a gender lens) and provided one-hour skype calls with the Criterion Institute to help intermediaries answer this section of the application. As a result of the training program and support sessions, several intermediaries are now incorporating gender lens investing practices into their overall core operations.

We support DFAT's work to develop a guidance note or policy on gender lens investing across its programs, and the opportunities it can provide to meeting the women's economic empowerment goals and complementing investor needs in this space. Gender lens investing is an area where government can play a leadership role.

## 3. Incentivise new private sector capital

Through our work, Coffey has developed relationships with a large number of global and impact investors. During the design of Pacific RISE, Coffey partnered with Sandy Blackburn Wright from Social Outcomes, an Australian-based intermediary, to consult with investors on what would make them invest in the Pacific Islands and what the Australian Government (through DFAT) could do to support this.

Investors indicated they would be more likely to invest in high risk ventures, such as new markets and developing economies, if the Australian Government could support to lower the risk and underwrite the deal. In particularly risky sectors, providing first loss position on defaults was a common request.

For example, if it was an equity level risk, they would ask a double digit return of 12-15%. However if there was some level of capital guarantee through an underwriting arrangement, they would accept a far lower return of around 5-6%.

In addition, many investors noted the significant role that social and development impact bonds play in supporting investment in social areas.

Social or development impact bonds can be formed when a social impact intervention saves the government from spending on social services (e.g. an intervention that finds employment would save the government future unemployment benefits). This saving (or part of) can be paid to the intervention upon success, rather than by providing upfront grants to fund the social or development outcome. Social or development impact bonds are typically paid conditional upon successful delivery of the outcomes, the service provider accepts the risk, and can fund its operations against the future cash flows from success payments, thereby attracting investors.

Australian state governments have trialled social impact bonds in a number of sectors. For example, the NSW Government worked collaboratively with UnitingCare Burnside and Social Ventures Australia

5 See more at http://impactalpha.com/pacific-rise-three-gender-lens-investing-truths-we-learned-developing-an-impact-strategy-in-the-pacific/

to agree a ‘payment by outcomes’ structure under which taxpayers effectively share the financial benefits flowing from the social impact of the Newpin program. Under Newpin[6], parents of children at risk under five participate in an intensive educational and therapeutic program aimed at breaking the cycle of intergenerational neglect and abuse. The program has restored 66 children who would otherwise be in foster care to their families costing social services. The success rate is well over double the usual rate for such programs. Newpin yielded a return of 8.9 per cent to investors in the $7 million bond by NSW Government in 2013. The program is expanding, with Government savings in the order of AUD80 million expected.

One investor noted that developing an annual series of impact bonds (combining social and development bonds) where there is a progressive transfer of risk from the government to the private sector would test these mechanisms in a number of different sectors and could encourage institutional investors to participate.

In all cases, it is important to understand the additionality of the government funding and to have clear communication with the public on the rationale for the Government funding impact investing especially when Government funding has allowed investors to receive financial returns. It is important to understand how the spending resulted in social services and resulted in savings to the Government, and particularly when de-risking an investment. It is important to confirm that the investment would not happen without Government funding.

## 4. Use public data to get better investments and to generate measurable outcomes

**Data analysis in planning investments**

Investment decisions are made based on analysis of financial and social data. Analysing past data and trends, forecasting these into the future and then discounting back to the present in order to understand the value of the investment relies on access to good social impact data. That means not just a single convincing data point for example about a women-led business, but a wealth of information about gender and social patterns that can enrich the investment process.

In particular accessing gender patterns and trends is a limitation for investors in the impact investment space. Working with women’s rights organisations, women’s programs, gender networks are critical for the investment process and making investment decisions, but often these organisations are left out of the process.

Government agencies and programs have really excellent data collection, research and analysis but often limited ways to provide this to the private sector or investors.

The Australian Government could develop a platform for sharing social impact data, in particular gender trends and patterns, to assist the impact investment industry to design and facilitate deals and to provide better decision making for investors. This could draw from, or be incorporated into, the online platform with the Australian Bureau of Statistics by strengthening the gender focus and look to supplementing the census data (collected every five years) with specific special interest surveys (collected more regularly) or data from other industry groups to address some of these issues, for example surveys of industry and retail by gender ownership and management.

Additionally the Australian Government can develop support programs to assist organisations such as women’s rights groups, social service providers and Australian not-for-profits, to understand how the investment and finance system work, how data can support better investment decision making and how to engage with capital.

**Measuring impact**

An important requirement of impact investment is the measurement of the financial and social impact. Impact measurement[7] shows the value a program is delivering to its beneficiaries and society as a whole, and helps ensure transparency and accountability. It enables stakeholders—government, investors, management or employees—to understand the effectiveness of a program in terms of its

6 https://impactinvestingaustralia.com/case-studies/newpin-social-benefit-bond/
7 https://impactinvestingaustralia.com/resources/impact-investing-2/

outcomes, and beyond its outputs. Importantly, it can be used to help improve the social impact a program generates. It can also develop additional social data to inform new investments.

However, few resources discuss the specific practices and methodologies that investors *actually* use to measure social impact.[8] The G8 Social Impact Investment Taskforce has established a working group[9] on measuring impact with aims including applying measurement best practices across impact portfolios, deals, and investee organisations. Providing guidance on the measurement of social impacts and contributing to discussions such as those established by the Taskforce working group the G8 social impact investment taskforce has established will be important for donors and new designs in future.

In Pacific RISE we also have developed core questions that the program will answer to better understand how to scale up impact investing in developing markets and inform future designs. These questions include: What are the actual constraints and disincentives to investing in the Pacific? What will attract investors to the Pacific? How can investing in women be seen as an opportunity?

Better measurement broadens the pool of data available to inform future impact investments. This information will assist to identify important patterns in the market and improve the understanding of markets for the investors. This will encourage growth in the investor industry.

Coffey would again like to thank the Treasury for the opportunity to participate to the discussion and welcomes any further involvement in the process.

8 https://ssir.org/articles/entry/how_impact_investors_actually_measure_impact

9 http://www.socialimpactinvestment.org/reports/Measuring%20Impact%20WG%20paper%20FINAL.pdf