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The rise of impact investing

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AN estimated US$2.281 trillion worth of investments in 2020 could be broadly considered as impact investments, which is about 2% of global assets under management (AUM), according to the International Finance Corp (IFC) in its “Investing for Impact: The Global Impact Investing Market 2020” report.

Of that, the World Bank Group member said US$636 billion went into measured impact assets — investment assets with a clear intent for positive impact, with a credible thesis of contribution and for which there is a measurement system in place — up 25.9% from US$505 billion in 2019.

In the broader market, where only the intent for impact is identifiable, there were US$308 billion of investments under private management, including US$245 billion of investments by 895 privately managed funds investing in private equity, venture capital, real assets, real estate, infrastructure or private debt, for which impact measurement in place cannot be observed, the IFC noted. Its broader market assessment included US$1.338 trillion managed by publicly owned development financial institutions and national/ regional development banks. Altogether, intended impact assets totalled US$1.646 trillion, up 5% from its 2019 estimate of US$1.567 trillion.

There is certainly growing awareness of the good that impact investing can do and impact investments have been growing as an asset class, says Darius Yuen, an investment banker who became one of the early proponents of impact investing in Asia more than a decade ago, when he founded the charitable foundation Sow Asia in Hong Kong, through which he helps channel such investments into social enterprises.

But what exactly are impact investments?

They are investments in companies or organisations with the intent to contribute to measurable positive social or environmental impact, alongside a financial return.

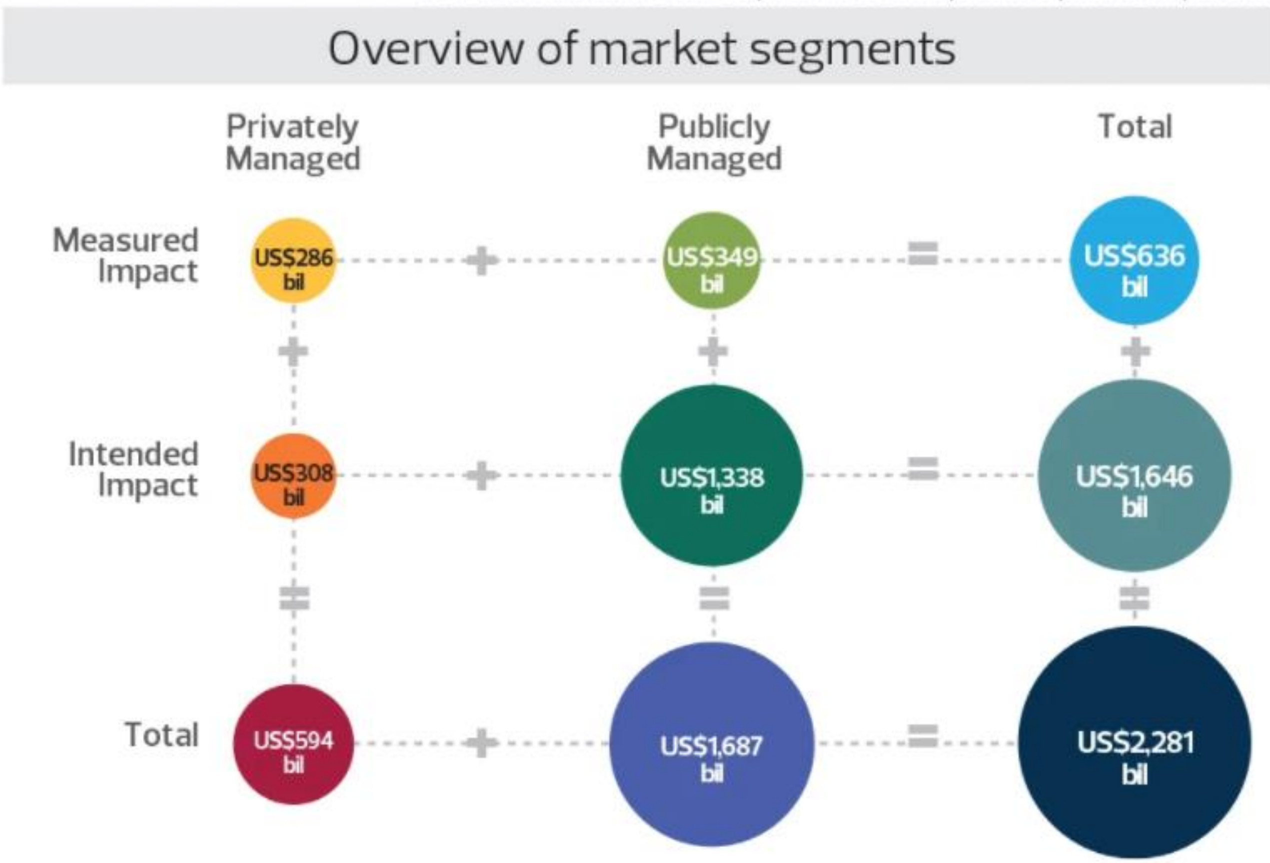
The origins of impact investing trace back to microfinance, where small loans funded micro enterprises such as farmers and entrepreneurs in remote villages, says Tassie Brakenridge, BlackRock's regional platform lead for sustainability in Asia-Pacific. She is also product strategist for BlackRock's global emerging markets equities, Fundamental Equity Group.

Malaysia's top-down situation

Impact investing has been gaining interest globally, including in Malaysia, where it is driven from the top, says Value Partners Asset Management Malaysia Sdn Bhd managing director Durraini Baharuddin.

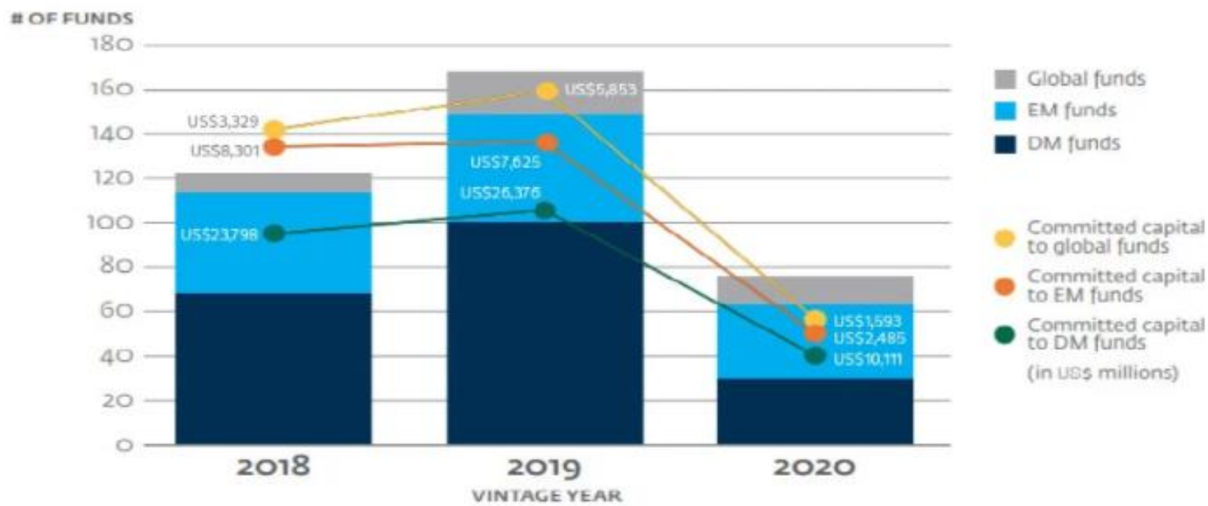
She cites, for example, Khazanah Nasional Bhd's announcement in the last quarter of 2021 of a RM6 billion Impact Fund that will focus on clear development-specific goals such as improving household incomes, creating high-value employment and achieving other socioeconomic outcomes linked to the national agenda and aspirations.

SOURCE: PREQIN, GLOBAL IMPACT PLATFORM, EMPEA, SYMINVEST, HIPSO, MDB MOBILIZATION REPORTS, DISCOSURE STATEMENTS TO OPERATING PRINCIPLES FOR IMPACT MANAGEMENT, DFI ANNUAL REPORTS, PITCHBOOK, CRUNCHBASE, IMPT+ACT



The IFC's report identifies assets that can be credibly observed to be managed with intent for positive impact, have an identifiable contribution, and have a measurement of impact. It calls investments that satisfy these three conditions "measured impact" investments. For investments that satisfy the intent condition, but do not observably and credibly satisfy both the contribution and measurement conditions, they are termed "intended impact" investments.

2020 saw fewer new impact funds and less fundraising



While Covid-19 sparked uncertainty across global markets and led to delays in fundraising for many funds, the IFC said there is evidence that funds are increasingly seeking out opportunities in more challenging environments, with more impact funds launched in 2020 focusing on investments in emerging markets (EMs) (33), compared to those focusing on developed markets (DMs)(30). "This shows that even during a global pandemic, impact investors are determined to invest increasingly where needs and investment opportunities are greatest," the IFC wrote in its report.

The Employees Provident Fund is also progressing towards making its AUM "ESG-aware" by 2030, Durraini says, referring to the pension fund's announcement in mid-2021 of its plan to be a fully compliant ESG (environmental, social and governance) portfolio by 2030 and a climate-neutral portfolio (with zero greenhouse gas emissions) by 2050, which reportedly made it one of the first Asian pension funds to publicly commit to sustainability.

"The interest was largely accelerated by various restrictions imposed on Malaysian companies and the negative publicity they face, owing to poor business practices that are detrimental to society and the environment," Durraini says in an email reply to The Edge.

Value Partners' Real Estate MD Rachel Tong says, "Though once a niche market, impact investing is now accepted by various groups of investors — including institutional and retail investors, foundations and family offices. As the industry evolves and global challenges increase, many investors are either incorporating impact investments across all of their assets or carving out a portion of their portfolios to test the strategy. There are a growing number of institutional investors that are committed to impact- and faith-based investing — including major banks, pension funds, asset owners and institutions.

However, the interest or focus from retail investors in Malaysia is not much, Durraini notes, unless there are superior returns.

Limited available investment solutions

While impact investment can be treated as an asset class, Durraini sees it forming part of a real asset or private equity/debt portfolio within an alternatives allocation. “A key challenge to categorising it as an asset class of its own is the limited available investment solutions in the country of domicile,” she says, noting that such is the case in Malaysia.

“In countries that lack depth in terms of options for impact investing, the most efficient way is to look at the key social/environmental problems existing in the country at that particular time and seek investment solutions or businesses that help [solve them].”

To tackle the issue of housing for low-skilled workers, for example, she says Value Partners has a private equity real estate fund (limited to sophisticated investors and institutional investors) that focuses on Purpose-Built Workers Dormitories in Malaysia licensed under the Securities Commission Malaysia. The fund contributes to the improvement of the living conditions of low-skilled foreign workers in the country, while providing investors with a stable income.

“A major challenge remains as to how to translate impact investing into real business value. In the meantime, capital and investors should focus on projects that are already yielding positive cash flow that meet some of the criteria of impact investing, with objectives to further enhance them,” Durraini adds.

In an email interview with The Edge, BlackRock’s Brakenridge says venture capital and private equity impact strategies play a critical role in building impact businesses across industries and geographies today, with public equity markets playing a growing and indispensable part in the impact ecosystem by driving impact and contributing at the investor, company and asset class levels.

She does not see impact investing as an asset class of its own, though. “If we were to accept the view that impact investing can be achieved only in a single asset class, we would also be accepting that impact investing cannot help solve the world’s great problems at scale. Alternatively, we can innovate and encourage others to develop new solutions that address these concerns. At BlackRock, we choose the latter path and believe that additionality and impact can also be achieved in public equities, for example. Public equities and bonds offer the potential to put capital to work towards social and environmental progress at an unprecedented magnitude," Brakenridge says.

What is for certain is that there is a growing cohort of investors to whom financial returns are not enough, she says. "These investors seek social and environmental progress in tandem with competitive investment performance. Impact investing through public equities provides an innovative mechanism to realise their objectives."

As the pandemic took hold and exacerbated many of the world's greatest ESG issues, BlackRock saw investors of all types and sizes choosing to tilt their investments towards sustainability-focused companies in a greater magnitude than ever before.

"In 2020, investors in mutual funds and ETFs (exchange-traded funds) invested more than US$360 billion globally in sustainable assets, more than double the amount invested in 2019. Client demand in every major region for sustainable investments continues to accelerate and we are seeing strong growth across index and active sustainable strategies. We managed US$509 billion in sustainable AUM as at Dec 31, 2021, more than double from a year ago," Brakenridge says.

Still, the global need for impact capital is of an order of magnitude greater than what could conceivably be provided by the private markets, she adds. "For developing markets alone, we face a shortfall of approximately US$2.5 trillion (RM10.46 trillion) annually to meet the SDGs (Sustainable Development Goals) by 2030. Existing contributions from companies, governments and other organisations are not nearly enough to meet this need."

Are impact investments the same as sustainable or responsible investments?

Impact investments are a particular type of sustainable and responsible investment. They have an explicit intent to generate positive social and environmental impact, in addition to considering environmental, social and governance (ESG) risks to operational or financial performance.

Malaysia’s growing interest in social enterprises

Government shows support with Budget 2022 incentives

- Tax exemption for all social enterprise income for up to three assessment years, subject to Social Enterprise Accreditation from the Joint Committee on Accreditation (comprising Yayasan Hasanah and the Ministry of Entrepreneur Development and Cooperatives);
- Extension of the Government Social Impact Procurement programme to all ministries. It was previously introduced on a pilot basis with the aim of increasing opportunities for social enterprises to participate in government procurements;
- RM10 million worth of grants for non-governmental organisations (NGOs) and universities to conduct social enterprise programmes; and
- RM14 million for the United Nations Development Programme on tourism activities and financing grants for start-ups, NGOs and local state-owned enterprises.

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Over the last couple of decades, an increasing amount of impact capital has gone into funding social enterprises.

Interestingly, the Malaysian government has also been actively supporting social enterprises, with specific allocations set aside for the segment in its recent annual budgets, where it has expressly stated more than once its intention to work with such entities, alongside non-governmental organisations (NGOs), in the national development agenda.

In Budget 2021, for example, it channelled RM20 million via the Malaysian Global Innovation & Creativity Centre (MaGIC) — an agency under the Ministry of Science, Technology and Innovation — to conduct a social enterprise development programme. At the same time, it launched a pilot social impact procurement programme under which social enterprises (those with a Government Impact e-Procurement Programme Certificate from MaGIC and other selected agencies) can supply goods and services worth up to a total of RM20 million annually to the government.

And from this year, as provided for under Budget 2022, the incomes of all government-accredited social enterprises will be tax-exempted for up to three years, while the pilot procurement programme will be extended to all ministries.

According to MaGIC's website, it has supported/helped develop more than 450 social enterprises, which it defines as business entities registered under Malaysian laws that proactively create positive social or environmental impact in a financially sustainable way.

Malaysia's continued interest in and initiatives for social enterprises are evident of its recognition of the value and impact of such entities, and the role they can play in improving the nation's socioeconomic landscape.