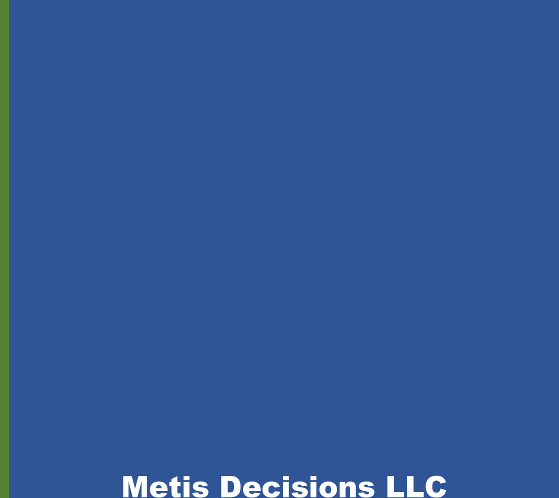

IMPACT INVESTING

IMPROVING SOCIAL OUTCOMES THROUGH INNOVATIVE FINANCING

Overview

Bad investments and non-performing assets are a bane, not just to the capital allocation business but constitutes macro risk to the entire economy.

Allocating capital to investments with strong performance potential against acceptable levels of risk, therefore, is obviously every portfolio manager's dream. But what if the capital market (supply-side) could leverage on more than just financial returns? What if an investment vehicle delivers strong social and environmental returns without compromising financial viability? What if ensuring returns on shareholder's capital is no more mutually exclusive with solving pressing social issues, which normally would have required public sector intervention to address? Welcome, to the world of Impact Investing, where private capital meets social innovation.

Background

Ghana is faced with persistent social and environmental challenges that require cost-effective solutions. Our ability to address important policy issues in education, health/sanitation and energy, inter alia, requires an integrated approach that links private, public and social sectors. Often, these approaches take the form of innovative business models that seek to balance private gain and public good. Impact investing is an approach to financing these new business models to accelerate positive social change. It demonstrates how finance can be harnessed to achieve measureable growth and positive change.

Impact investing as a term was coined in 2007 by a group of stakeholders referred to as the Rockefeller Impact Investing Co-operative (RIIC). The problem statement at the time was the misalignment between the need to guarantee financial returns and the imperative to drive social innovation as a way to solve developmental problems. Evidently a breakthrough in investment thinking, Impact Investing as a model, was developed to address the failure of markets and public policy in ensuring social justice and equity. Albeit there has been an encouraging adoption rate globally since 2007, the practice (Impact Investing) is still yet to gain the needed traction in boardrooms and policy arenas in developing countries.

The mechanism for linking investment capital with social innovation requires both private and public sector support in order to optimize growth. Within that ecosystem are; banks, research institutions, venture capital and private equity, regulators and social entrepreneurs. Social entrepreneurship is the key element that drives demand and sets a context for the need to align capital supply with development priorities in areas such as health, sanitation, skill development, et cetera. The proven ability of social entrepreneurship to positively affect public policy agenda in developing economies, has even compelled a re-modelling of overseas development assistance by donor countries. This is reflected in a trend whereby successful private actors within the social space are offered prestigious international platforms to discuss policy options for developing economies. This issue paper discusses the following questions:

1. What is Ghana's degree of adoption as far as Impact Investing is concerned?
2. What are policy implications and how can we build a strong ecosystem to support social entrepreneurs in Ghana?

Before attempting to address the issues laid out however, there is a need to lay proper context in order to ensure clarity on key frameworks and concepts.

Two Sides of the Same Coin

Impact Investing and social entrepreneurship represents the two

main drivers of the “social capital” market. Investors supply capital to social entrepreneurs for their social impact activities. It is important therefore to define both concepts very clearly. Entrepreneurship is very popular discipline and has benefitted from copious literature for one simple reason; it is a very sexy topic, particularly in environments where unemployment is really high. The focus of Impact Investing however goes beyond the general definition of entrepreneurship to address the implication of the word “social” in social entrepreneurship. A quick distinction will help clarify the point. So an entrepreneur is someone who identifies a social and/or environmental need, and rightfully perceiving it as a market gap, brings into play, in an organized manner, factors of production, to meet that market need thereby making a healthy return on investment as a reward for risk taken. Well how is that different from social entrepreneurship? Not much, except for the word “social”, which essentially qualifies the entire dynamics of how the venture is organized and the balance between risk and return. “Social” effectively influences the nature of market gap or need that the entrepreneur chooses to disrupt. Usually, such gaps are present because the market has settled at a sub-optimal equilibrium where consumer dissatisfaction is at the highest and utility at the lowest. It is also usually the point where public policy and market regulation has failed to address issues of social justice and equity. Typical examples in Ghana; drug counterfeiting, informal sector taxation, waste and sanitation management, buyer-beware rental market, the list is endless. All of these market disequilibria, one way or another, results from a combined effect of policy failure and market inefficiency. What social entrepreneurship does, is to deploy an effective business model, using technology, to eliminate market risk and in so doing return an acceptable amount on capital invested, at the same time addressing key policy issues as identified in the examples above. The success of social entrepreneurship as a development model can be seen more clearly in its sharp contrast with other forms of social organizations, such as NGOs and policy advocacy institutions. Key differences:

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a) The capital structure mix widens far beyond the normal grants available for social actors. It includes equity and debt in all its variant forms; working capital, subordinated debt, convertible loans etc. NGOs and advocacy outfits normally rely on grant only as their source of capital support.
b) Social entrepreneurs are able to demonstrate commercial viability thereby guaranteeing financial returns, in addition to social and

environmental returns. NGOs and advocacy outfits play only to the social and environmental return tune.

Due to these reasons, social entrepreneurship organizations are better positioned as effective instruments of change as far as direct action is concerned.

This brings the focus on what Impact Investing really is, what it does and why governments must pay attention. Impact Investing is the act of making investments into companies, organizations, and funds (yes, investment funds such as hedge funds) with the intention to generate measurable social and environmental impact without compromising financial return. This is a view shared by a key global institution within the Impact Investing space, Global Impact Investing Network (GIIN). The key factor is the emphasis on balance between the social/environmental and financial. Admittedly, Ghana is far from developing an ecosystem that supports this kind of investments by private actors, yet incremental progress is needed to ensure that we focus social innovation and private capital on solving key policy challenges. The list of Ghanaian-based social ventures that have taken the lead to go global is definitely encouraging. It demonstrates, not just performance potential but also affirms the notion that innate human capacities for reasoning and problem solving is not an exclusive preserve of any race, color or ethnicity.

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Speeding up Adoption

Within the public space, GIMPA Centre for Impact Investing (GCII) and the Venture Capital Trust Fund (VCTF) have been instrumental in promoting Impact Investing in Ghana. Development within the private sector however, is still evolving, leaving room for innovation and bench-marking. Private sector convention in terms of social investment financing is through Corporate Social Responsibility (CSR) programs. Emerging trends in the sector shows the deployment of hived-off non-profit vehicles, bearing the brands of its

sponsors with "Foundation" as the name extension. An interesting trend nonetheless. Mainstreaming social impact financing in Ghana, the way Impact Investing does it, requires a well-integrated ecosystem that addresses investor concerns relating to project choices, infrastructure deficits, measurement frameworks and policy incentives. Increased adoption rate by the private sector of the Impact Investing wave is a proxy indicator of growth and must be encouraged through careful system and policy design.

This year (2014), RBC, private Bank in Canada, joined the ranks of other global brands such as Deutsche Bank, to launch a $20m Fund as a central part of their impact investing strategy. In 2012, the company (RBC) established the Generator Fund as a $10-million pool of capital to invest in for-profit businesses that tackle social or environmental challenges while generating market or near-market financial returns. Investment areas included energy, water, youth employment and community hiring for disadvantaged groups.

For Ghana to make meaningful impact in the social sectors, private capital must complement public policy to address key developmental issues. CSR programs are good, but major impact can only be achieved with sizeable social investments channeled through social entrepreneurial vehicles.

Implications for Public Policy

The establishment of GCII bodes well for the growth of Impact Investing in Ghana. This notwithstanding, more needs to be done to build a strong and supportive ecosystem that encourages social entrepreneurs to disrupt inefficient markets and build new business models for delivering economic value and social change.

The challenge of ensuring market convergence in the area of impact measurement is essential. Measuring environmental and/or social returns on a project presents a greater cognitive challenge than measuring financial returns. Albeit relevant models exists, there is a need for adaptation to ensure market peculiarities are taken into account.

The matter of policy incentives to encourage private capital for social investment also requires official attention.

Key Recommendations

- Public sector must lead and coordinate research and development of measurement models in consultation with private sector in order to promote involvement.
- Align tax regime with private sector adoption.
- GIPC, CIMG and other corporate rating bodies should consider including social impact activities as a ratable variable.

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