Responsible Finance for Digital Inclusion: Investing for Impact
Washington, DC| April 3-4, 2019

Session Date & Time: April 3, 2019, 9:45 – 10:45
Title: What makes us impact investors?
Moderator: Jürgen Hammer, Managing Director, SPTF Europe
Panelists:

- Kelly McCarthy, Director, Global Impact Investor Network (GIIN)
- Loïc De Cannière, Managing Director, Incofin Investment Management
- Sachin Vankalas, Director, Operations and Sustainability, LuxFLAG

- Jürgen Hammer (SPTF) started with an introduction to the session.
    - He noted that not long ago, our industry had never heard about responsibility or impact when talking about financial markets. Decisions were about returns. Microfinance was the first recognition that a social promise could come with the concept of sustainability. Still, for decades, this remained a marginal sector of the financial markets.
    - If you look at the situation today, we all agree that we have seen a huge change. The concept of responsibility of impact is now basically everywhere. We don't see corporates or financial institutions that don't refer to their impact and responsibility in communication and reports. Is that an opportunity, or is that a threat to microfinance?
    - We wanted to start our two days with that discussion: ***What makes an investor an impact investor vs. an investor referring to impact? Is intent enough?***
- Kelly McCarthy (GIIN) noted that the number that the UN calls for to achieve the SDGs is $5-7 trillion. We are far from the amount of capital needed. How do we get more organizations, more institutions, more capital to think about these issues?
    - The GIIN put out a roadmap for scale. It calls for three things regarding this question:
        - Establish a set of common, mutually agreed principles that define what it means to be an impact investor. How do we think about the shared identity for not only who we are but we do? What are the characteristics for impact investing?
        - Standardize best practices for impact management and measurement.
        - Collaborate across the capital spectrum. One interesting initiative is C3, which is a large pool of catalytic capital through players like the MacArthur Foundation and the Rockefeller Foundation, which help to direct more capital into this space through a collaborative platform.
    - Defining the characteristics of impact investors comes up in various ways: the desire to segment the market; the desire to name who's in or who's out; or the desire to think about whether everyone who calls themselves impact investors are making investments with integrity.
    - How GIIN defines impact investment:
- Intentionality and setting peer goals with a concrete theory of change

- Investment grounded in evidence. Setting targets through data using the best evidence available. Consider the beneficiary voice and use of right indicators. Impact investors don't make decisions only based on intuition or intentionality.
- Impact management: Use concrete information to think about how you increase positive effects or minimize negative effects. "If we don't know what works and what doesn't, we're throwing money to the wind."
- Contribute to the industry and acknowledge that no single institution has the ability to combat these challenged on its own.
    - Kelly said we can debate whether we agree or disagree, but these are the things we think are foundational.
    - She said the industry has been talking about a common language for impact management with the Impact Management Project. It's trying to clarify a couple of questions: How do we understand impact? Let's get that out of the way so we can build and collaborate clearly with each other. The Impact Management Project has identified five dimensions for that discussion:
        - *Who*. Be clear about who you're trying to benefit.
        - *What*. Have a clear idea of the outcomes and goals that the investment or portfolio is trying to achieve.
        - *How much*. What counts? Tying that back to the first two questions.
        - *Contribution*. How does that investment contribute to the outcome itself.
        - *Risk*. Do you have evidence to back up any of that information? What is the risk that the capital you're deploying toward that outcome will or will not be achieved? Kelly noted that this is the question people most want the answers to but is least developed.
    - The Impact Management Project has segmented intentionality into three categories:
        - **A**void harm. Negative screens, etc.
        - **B**enefit. Actively think about how the capital might benefit certain populations or the planet.
        - **C**ontribute to solutions. It's possibly the hardest, and it could carry the greatest risk because a lot of that territory is underexplored.
    - Question from the audience: Where do you see microfinance in that spectrum?
        - Kelly said she thinks it's a moving spectrum. Over time, different parts of investment activity fall into different aspects of the spectrum based on what we know and what's been proved. At certain times, microfinance was definitely in C. Now, she thinks we're in the B column because we know a lot more. We have the ability to scale and continue to do work without having to take as much evidence risk.
- Loïc De Cannière (Incofin) provided an overview of Incofin's work on impact.
    - In 2007, Incofin started thinking about how it could make the way it thinks about impact more specific and tangible. It developed a proprietary tool called ECHOS, which would screen for five dimensions: Environment, Customer Service, Human Resources, Outreach, and Social Mission. It had 40 indicators, and Incofin demonstrated positive correlation between social and financial performance.
    - In 2012, SPTF released USSPM, and Incofin began to think about what was in line with what the industry was thinking about social performance. Microfinance can harm. It can create over-indebtedness and do a lot of damage to clients. It became important to look at that. Incofin reviewed the tool and included more dimensions

- 2014 – 2016, the SPI4 was developed and released as an industrywide way of looking at investments.
  - In 2016-2017, Incofin began using SPI4 ALINUS, which aligns investor due diligence through with an abbreviated SPI4 module (containing 80 out of the 200 SPI4 indicators).
  - In 2017, Incofin also began to think more broadly about impact. It decided to adopt a four-step approach:
- Clear impact thesis. Only select investees that aim for a healthy balance between social, environmental, and commercial goals.
- Due diligence. Assess the operational performance of an investee through a comprehensive social and environmental audit, embedded in Incofin's "ECHOS 2.0" (SPI4/ALINUS) impact and risk tool.
- Measuring impact outcome. Help investees develop a realistic impact strategy where they positively and sustainably impact the lives of their end customers. He said that one of Incofin's challenges is that it's a minority shareholder. It has to convince management that managing outcomes is important. It's important that the claim of impact is justified.
- Exit. Ensure that each exit meets the financial objectives of investees and sustained impact post-exit. It developed a fitness and suitability review that is necessary to ensure a buyer will maintain the mission of the company.
- Sachin Vankalas (LuxFLAG) discussed another issue related to the definition of impact investment: accountability and transparency.
  - Sachin works for LuxFLAG, a non-profit in Luxembourg that offers labels for investment funds active in responsible investing. It checks of confirms that the claims asset managers make have real value. It's a signal that confirms that investment managers or funds do what they claim to do. "If you say you're a microfinance fund with social impact, you have to show us your doing."
  - Each fund that applies for a microfinance label has to have a social performance policy in place. The current trend is looking beyond microfinance at SDGs, financial inclusion, etc. Things are not that easy in terms of SDG mapping. As an industry, we have a lot to do in that side.
- Jürgen: Defining a microfinance fund seems relatively obvious, but how do you address the challenge of evaluating or labelling an impact fund in the absence of a clear definition? Where do you see the next steps to also help the quality or the meaning of investors with that label?
  - Sachin: We look at what type of institutions these investors invest in. We look at other indicators and then conclude whether it really can be called microfinance or not. We often make these decisions on a case-by-case basis.
  - As you mentioned, there are many differences in understanding and putting together all these things. On terms of standardization, there's a lot of work going on in the EU Commission level. They have done significant work with high-level executive finance. Hopefully that will provide us a base of what we understand is a base for sustainable investments.
- Question to the audience – How does your organization address or define these topics of impact?
  - Francois Ritchot (Enclude): We have many institutions create funds or transactions. The IMP framework is really helpful to get to that answer. It provides a common framework for investors to agree on where they are.

- Francois asked Loïc: Have you found that reporting on outcomes helped you with responsible exits? If you have a clear theory of change that you can work on results, other impact investors with the same mission would be interested in that asset.
  - Loïc: It's too early to say that. It's a very expensive and labor-intensive job. We hope a few years from now, we'll be able to say more. What I can say, is those investments that are more impactful have attracted investment from big names (both in Cambodia and India) in terms of the private equity world. We attracted names that are superstars.

- Thomas Koch (DEG) said the number one objective is reduce poverty, create jobs. You can come up with 100 indicators, but take a step back and think, what is the core of your institution?
  - Loïc said he hopes that's true of any impact investor. "But you cannot forget that things might go wrong. I was shocked as an investor during the India crisis when things go wrong systematically and you reach the opposite of what you're trying to achieve. I think it's essential to manage impact and be very detailed. I'm very convinced of that."
  - Thomas said he agreed to the lessons learned from the MFI world and the MFI markets in India and other countries where there were terrible consequences. I'm convinced all of the MFIs have drawn a line. It comes back to how are you judged. And I still boil it down to the jobs. I I'm afraid you're losing sight and focus if you're measuring all of the aspects in a single project. I understand that you're measuring risk and mitigating risk. My worry is you're losing sight if you're making it too broad. You're catching too many justifications. I favor a clear focus. If you compare yourself to commercial investors, they say they're here for profit measurement.
  - Loïc said the two questions Incofin is measuring related to outcomes is the percent of clients who found a job and the percent of clients' income increases.
  - Laura Foose (SPTF) noted part of what indicators look at is how well the product design process takes client protection and over-indebtedness issues into account. Both are issues that could take an outcome down the other way.
  - Thomas said he's in line with worries about over-indebtedness. That's a real challenge. However, he wants a clear focus, and for him, that's jobs.
  - Kelly said that many people would say, "My thesis is that I'm going to double down on climate change." They're desperately seeking simplicity on something that is actually a very complex discussion and requires a shared framework. For example, in order to share financial performance, we need agreement on the fundamentals. We talk about P&Ls, income statements, rigorous standards. We build around a lot of models on these. It's a lot of complexity for us to have a shared framework. In order to share financial performance, we have to agree on some of the fundamentals of how we think about some of these issues and how we get there.

- Mayada El-Zoghbi (CGAP) said she appreciates the need for simplicity, but nuance is important. You cannot make claims that you cannot support. It's not the time to make new false claims on jobs and on incomes. The evidence does not support that microfinance creates jobs. We should not be unifying behind something that we cannot support. Transparency on what we really achieve vs what we promise is important.

- Safeya Zeitoun (symbiotics) asked Loïc: If you find the outreach of your investments aren't what you anticipated, how does that factor into your decision-making process? Do you provide assistance to the institutions to reach their objectives, or do you simply provide them with a verbal reassurance that they are doing OK?
    - Loïc said that with equity investments, you can't just say you're leaving. You have to make sure your exits happen in the best possible circumstances. We train the company and investees in SPM to make it clear that SPM and impact management can improve the financial and social return of the institution. The technical assistance facilities train people to try and ensure they understand that the investments make business-sense and they are being transparent with their investors.
- Isabelle Barrès (Smart Campaign) said it's not one or the other. It is important whether we're investors or others to take a step back and observe the bigger objective. The more details you go into continue to be of service to those higher levels, but the details can often lead to becoming derailed or sidetracked. The higher-level objective of creating jobs is more important rather than talking about more base-level intricacies. We've made a lot of assumptions that practices at the FSP level are going to lead to good outcomes at the client level. We're testing those. I like the way we've started framing this around financial health. Ensuring clients are better off, rather than just increasing access or increasing usage. It's an urgent call for these people in this room who have taken this impact question seriously. To share that experience together and come up with clear definitions to make sure we're not diluted in an impact washing world.