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# The business of aid in the Indo-Pacific

## Submission to The Foreign Affairs and Aid sub-committee of Federal Parliament's Joint Standing Committee on Foreign Affairs, Defence and Trade.

**Executive Summary**

Contributions by the private sector could significantly enhance the reach and impact of Australia's current foreign aid efforts.

This paper submits that some portion of Australia's aid budget should be allocated to investment, rather than grants and capacity-building. The primary arguments are:

1. Using investment prudently can multiply the impact of Australia's scarce aid funds, many times over:
    - Investment aims to use the funds and then return them to Australia for re-use
    - Co-investment further leverages the impact of investment dollars

2. Investment impacts the target economies in ways that are complementary to grants, and serves to build the local economy, including by generating:
    - Sustainable employment
    - Wealth creation through enterprise
    - Capacity in business operations
    - Entrepreneurship culture and environment
    - Local tax base
    - Customers for Australian exports

3. Investment also unlocks capital for the target economy
    - Business attracts business investment
    - Business enables access to global capital markets

4. Investment fosters independence, while grants can foster dependence

This submission illustrates the benefits of the proposal, by applying learnings from a corollary sector, the charity and philanthropy sector.

**Experience from the Charity & Philanthropy sector**

The domestic US and UK charity and philanthropy sectors have two critical features which parallel the situation facing decision-makers concerning Australia's foreign aid.

- The problems faced are enormous and overwhelm the donation dollars available.
- The problems are growing, just as the donation budgets are under pressure.

In response a new, global movement is taking root: Impact Investing.

Impact Investing is generally defined as investment capital with the intention of receiving both an acceptable financial return and a measureable social impact return.

The movement was sponsored by large philanthropic donors seeking to do some good, not just with the 5% they gave away each year, but with the 95% corpus which is invested to generate the returns for giving. By beginning to consider the impact their investment dollars had, they were able to design ways that met their fiduciary responsibilities, but also had significant social impact.

Many foundations select investments that align with their mission, for example, such as focusing on a specific geographic region or disease.

Since 2007, impact investing has grown significantly. A 2011 report from J.P. Morgan[1], based on surveys by the Global Impact Investing Network (GIIN), suggesting that approximately 2,200 impact investments worth $4.4 billion were made in 2011, up from 1,000 deals worth $2.5 billion the year before.

A 2008 estimate[2] by the Monitor Institute estimated the industry could grow to $500 billion within five to ten years, representing an estimated 1% of global assets under management. Some 1400 investment funds now identify themselves as impact investments, and some 70 are in current fund-raising.

Another corollary is a corporation. The way is does its business is far more impactful than the 1% it might allocate to its Corporate Social Responsibility program. It's manufacturing processes, procurement requirements, trade policies and employment practices all have the potential for great social and environmental good, or bad.

[1] http://www.thegiin.org/cgi-bin/iowa/resources/research/334.html

[2] http://www.gbn.com/consulting/article_details.php?id=88

## Impact from Investment

Australia can reduce the aid grants (National philanthropy) in favour of investing into the target economies. This could be managed through a Sovereign Social Investment Fund, or even a Development Finance Institution (which many of Australia's peers have long held).

Investment impacts the target economy in ways that are complementary to grants and capacity building. It builds the local business ecosystem, growing employment (and a tax base), management skills, and attracts other capital markets players…leading to easier access to capital.

Investment serves to leverage private sector funds, increasing the impact for limited budgets. Carefully structured, this leverage can be significant without increasing risk to the investee.

Investment builds independence in its recipients, where charity can breed dependence.

Investment stretches National aid budgets by preserving the capital to be re-used once it has been returned upon repayment. Australia can provide funding in such a way that it gets repaid and re-circulated multiple times.

Investment is not applicable in all circumstances, and we propose that it be trialed with a modest amount, until its benefits are demonstrated.

## Sectors

The impact investments can generally be described in 3 groups:

1. **Services** – This is the delivery of on-the-ground social services. Much of this has focused on Social Impact Bonds or Social Benefit Bonds. This instrument can be formed when an intervention that saves government money (reducing recidivism or unemployment) can be paid for upon success, rather than by up-front grants. The contract with government involves payment being conditional upon successful delivery of the outcomes, so government only pays when they have saved. The service provider accepts the risk, and can fund its operations against the future cash flows from success payments, by attracting investors.

   There are several pilots on Development Bonds, where government makes its aid grants conditional on successful delivery of outcomes, and the main attraction is the "Pay for Success" feature.

   Other arguments are that this approach generates innovation in delivery, promotes more efficient practices, and shifts risk.

2. **Enterprise** – This area has received the most attention, as the scaling of a successful social enterprise can deliver huge impact, large employment and, potentially, large financial returns. The best known group of these is probably in micro-finance and other financial inclusion initiatives, that have grown to service hundreds of millions of poor, who would otherwise be excluded from access to finance.

   But there are tens of thousands of social enterprises being started and expanded, and funded. And emerging economies are being stimulated as impact occurs, through the growth in employment and capacity.

   The Skoll Foundation may be the best known proponent of social enterprise, and its annual world forum attracts investors and entrepreneurs in an intense funding and deal-making week.

   It may also be that the growth of social enterprise reflects the business background of many of the ultra high net worth investors driving this sector.

3. **Infrastructure** – These projects are the biggest dollar commitments, but can also have country-wide implications, such as hydro-electric dams or transport networks. They are also the easiest to finance through investment, and the hardest to justify with grant dollars. By skillfully applied socially-intended investment (strategic guarantees, foreign exchange cover, etc) can unlock projects that would otherwise not get funded. Some of this overlaps with EFIC (Export Finance & Insurance Corporation), but should prove the concept.
   But infrastructure can also be such items as mobile payment platforms, a school syllabus, clean water or sanitation facilities.

The majority of early stage impact investments was focused on the domestic US (and UK) markets but now the focus is on emerging economies.

There has been much work on the preparation of recipient entities for investment-readiness, and some of this work is funded by grants.

An Australian Sovereign Social Investment Fund would benefit from the development of this ecosystem, and could help propel it along in the priority regions.

## Private Sector Involvement

In addition to a new investment approach engaging with the private sector in target economies, it will be critical for DFAT to incorporate private sector expertise to establish any such investment activity.

The principles of sound investment, investment management and reporting must be present, or the investments will be bad ones.

The only way to address this issue is to partner with private sector experts to establish the fund, and to bring investment expertise. Seconding DFAT people into the investment management, would serve to transfer the IP over time.

## Conclusion

The development of investments which intentionally create positive social outcomes, is widely see as the answer to the funding needs of the US and UK domestic social sector.

This submission proposes it could be used to great effect in the context of Australia's foreign aid program.

Many of Australia's peers in the G20 have taken the investment approach. See Appendix 1 for a partial list.

This paper proposes that such an approach could form part of the solution to how we can best use Australia's limited aid dollars to generate the desired impact on as big a scale as possible.

Yours sincerely

Andrew Tyndale
Founder/Director

**Biography**

The author is an investment banker with more than 30 years experience in buying and buying into companies, in creating and managing industry-specific investment trusts. He has held directorships, executive and non-executive, in dozens of public and private companies.

He is the inaugural awardee of the Fulbright Professional Scholarship in Non-Profit Leadership, and is currently in the US studying social and impact investment.

As part of the Fulbright, he is meeting with industry leaders from investors to intermediaries and recipients of impact investment, to capture what could work in Australia. He attended the 2014 Skoll Word Forum on Social Entrepreneurship in Oxford, UK.

## Appendix I: National Development Finance Corporations

| Name | Sponsor Country | Mission / Description | Fund Size / Website |
|---|---|---|---|
| CDC Group (formerly the Commonwealth Development Corporation) | United Kingdom (owned by Department for International Development) | CDC's objective is to invest in a commercially sustainable manner in the poorer countries of the developing world and to attract other investors by demonstrating success. CDC's capital is focused on the private sector as the engine of growth. | Stg1.4bn (in 134 funds managed by 65 managers)<br><br>www.cdcgroup.com |
| Proparco | France (owned by French development agency, AFD) | PROPARCO promotes private investment in emerging and developing countries with the aims of supporting growth, sustainable development and the Millenium Development Goals. Projects include infrastructure (eg roads, telcos, energy), financial inclusion and climate change. | www.proparco.fr |
| Swiss Investment Fund for Emerging Markets (SIFEM) | Switzerland - for State Secretariat for Economic Affairs and other public and private investors | Finance to promote equity funds (eg South Africa Vantage Mezzanine Fund) and FIs investing in SME sector in emerging markets | US$409m<br><br>www.sifem.ch |
| Development Bank of Southern Africa | South Africa (and SADC) | Accelerate sustainable socio-economic development by funding physical, social and economic infrastructure, eg water, RE | R37b<br><br>www.dbsa.org |
| KfW Banken Gruppe | Germany | Climate change, education, energy, FIs, health | Eu400b (assets)<br><br>www.kfw-entwicklungsbank.de |

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|---|---|---|---|
| DEG | Member of KfW group | Finance investments by private sector in emerging economies | Eu3.5b<br><br>www.deginvest.org |
| Belgium Investment Company for Developing Countries (BIO) | Belgium | Support MFIs funding businesses and SMEs, also infrastructure and funds, eg RE | Eu500m<br><br>www.bio-invest.be |
| Netherlands Devt Finance Corporation (FMO) | Netherlands | Entrepreneurial development bank, providing capital and advice to promote the private sector, eg housing, energy, FIs, food | Eu4.6b<br><br>www.fmo.nl |
| USAID Credit Guarantee Fund | USA | Guarantee up to 50% of private sector lending to sectors such as water, energy, health and agriculture | US$130m[3]<br><br>www.usaid.gov |
| Finland Fund for Industrial Cooperation (FinnFund) | Finland – projects that involve a Finnish interest | Loans and risk capital for profitable projects in emerging markets, eg medical, environment, mills (steel, paper), RE, aviation | Eu$188m<br><br>www.finnfund.fi |

[3] 267 partial credit guarantees have facilitated over $2.3 billion of private capital debt