IMPACT Investing
AUSTRALIA

# Inquiry into the Role of the Private Sector in Promoting Economic Growth and Reducing Poverty

## Submission to the Joint Standing Committee on Foreign Affairs, Defence and Trade, Foreign Affairs and Aid Sub-Committee

### Submission May 2014

IMPACT Investing AUSTRALIA

# Inquiry into the Role of the Private Sector in Promoting Economic Growth and Reducing Poverty

**SUBMISSION MAY 2014**

## Overview

This submission responds to the Foreign Affairs and Aid Sub-Committee of the Joint Standing Committee on Foreign Affairs inquiry into the role of the private sector in promoting economic growth and reducing poverty in the Indo-Pacific region. The submission responds in particular to the role of impact investment in international development, and specifically focuses on the following questions included in the inquiry's terms of reference:

- Additional partnerships, activities or financial instruments the Australian government could use to enhance the role of the private sector in development in the Indo-Pacific region.
- The role of public-private partnerships in leveraging private sector investment in developing countries.

It also directly responds to the suggestion of the Foreign Minister, Hon. Julie Bishop MP, that the Committee pay close attention to:

- What other donors (new and traditional) are doing in this area.

The submission highlights a number of ways the impact investing sector is developing, and examples of initiatives directing private sector activity and increased private capital to international development objectives. There is substantial opportunity for Australia to leverage these developments and gain significantly from engaging in impact investing for international development.

A number of recent events - most notably the work of the international Social Impact Investment Taskforce (for which Australia is currently the only non-G8 country participating) and its focus on development investment – means timing is opportune for Australia to work on implementing innovative structures to facilitate the role of the private sector in development programs of the Indo-Pacific. Engaging in the sector would augment economic growth and trade in key regional strategic markets for Australia, increase investment opportunities for the Australian private sector, and support long term, sustainable development goals.

## The Emerging Role of the Private Sector in Social Impact

The private and financial sector has always been a key component of social and community development. It catalyses new markets, sponsors entrepreneurialism, provides jobs and incomes (in turn generating revenues for tax and infrastructural development), and operates across all sectors.

In recent years, this intersection between social and economic development has developed from being passively acknowledged, to actively promoted by leaders across all sectors. For example, one of the leading international authorities on economic growth and business strategy, Professor Michael Porter, argues that "*the strongest businesses of the future will be those that align making profit with creating social progress,*" and points out, "*there is nothing soft about the concept of shared value... [it represents] the next stage in our understanding of markets, competition and business management"* (Porter and Kramer, 2011).

In both developed and developing economies, governments struggle to 'fill the gap' between the increasing demands on social welfare, and ability to fund such programs. In the developing economies of the Indo-Pacific region, these pressures are made more acute by low tax revenue; degraded infrastructure; and great needs in numerous sectors including health, education, and housing.

> *I think societies everywhere will come to the conclusion that an important part of the capitalist system is having a powerful social sector to address social issues, because government doesn't have the resources* (Sir Ronald Cohen, Founder Apax Partners, Chair International Social Impact Investment Taskforce, quoted in *The Telegraph*, 26 June 2010).

The importance of promoting private markets as a means to build social cohesion, increase productivity, and improve livelihoods is well recognised, and of course, reflected in the mandates and mission of the Australian Department of Foreign Affairs and Trade.

In the context of international development, it is increasingly recognised that grant and aid based approaches are necessary, but not sufficient, to respond to the magnitude of the challenges. For example, the Bill & Melinda Gates Foundation, the largest philanthropic foundation in the world, has around $40 billion in capital. If those funds were used to provide cash grants to the world's poor, it would provide around $10 per person, at which point the capital reserves would be depleted (IMPACT Australia, 2013). Aid and grants also may not be the most effective approach in all contexts.

There is recognition that strategically targeted policy to encourage development investment can leverage scarce government funds, advance foreign policy, and provide new opportunities for the private sector in growth markets.

> *During the past century, governments and charitable organizations have mounted massive efforts to address social problems such as poverty, lack of education, and disease. Governments around the world are straining to fund their commitments to solve these problems and are limited by old ways of doing things. Social entrepreneurs are stultified by traditional forms of financing. Donations and grants don't allow them to innovate and grow. They have virtually no access to capital markets and little flexibility to experiment at various stages of growth. The biggest obstacle to scale for the social sector is this lack of effective funding models* (Sir Ronald Cohen and William A. Sahlman, 2013).

Examples like microfinance, community development finance, and investing in the 'bottom of the pyramid,' demonstrate how this might work.

> *The dominant story that we are told about poverty is that these people live hand-to-mouth – a storyline that leads us to treat people as passive beneficiaries rather than agents. In fact, 85% of low-income people are emerging consumers, willing and able to pay for essential products and*

> *services, if only offered, to help them to rise out of poverty and into the middle class* (Leapfrog Investments, 2013)

Progress has already been made in the movement from 'aid' to 'investment' in international development programs in countries to which Australia often looks to benchmark and model policy, such as the UK and USA. The shift reflects a focus on building local capacity, and potential to promote sustainable developing economies; as well as the opportunity to facilitate entry points to growth markets and trade connections with donor countries. At the Global Impact Economy Forum hosted by the US Department of State in 2012, investors including pension funds, sovereign wealth funds, foundations, banks, and international financial institutions agreed development investment could generate "*business opportunities that analysts estimate could reach between US$500 billion and several trillion dollars over the next decade*".

> *In the 1960s, official development assistance represented about 70 percent of capital flows into developing nations. Today that number is about 13 percent. Where does the rest come from?... it comes from the private sector, comes from increased trade revenues, it comes from the flow of remittances, and any number of other non-governmental sources… if we can open the doors to new markets and new investments, we can tap as many as 1.4 billion new mid-market customers with growing incomes in developing countries. Taken together, they represent more than $12 trillion in spending power…So when we make investments from the three stools of this strategy, official development assistance, not-for-profit philanthropic assistance, private sector investments, we are not only helping to grow and strengthen middle classes in developing nations, we are also supporting the businesses that create jobs here at home. We know that working with the private sector can bolster both our foreign policy interests and our development efforts* (former Secretary of State, Hillary Clinton, 2012)

Supporting private sector growth in targeted geographic regions like the Indo-Pacific, has potential to create new markets for exports, foster greater trade connections between Australia and the Indo-Pacific and promote improved diplomatic relations, cultural exchange, and global thought-positioning for Australia and the region.

Recent research indicates that the private sector has significant interest in accessing emerging markets. Accenture (2012) finds that 73% of the 600 corporations surveyed believed they needed to accelerate their entrance into emerging markets, but were not fully equipped to do so. Barriers cited relate primarily to market entry points and risk management, both areas for which there is precedent for government to play an enabling role.

## The Role of Impact Investment

The great potential of market-based solutions to poverty and economic growth is increasingly recognised. Social impact and international development sectors are now actively supporting "a *move away from a culture of philanthropy, paternalism and dependence towards one of empowerment, entrepreneurship and initiative"* (UK Social Investment Taskforce, 2000).

Whether referred to as 'creative capitalism' by Bill Gates; 'social business' by Nobel Laureate and Founder of Grameen Bank, Muhammed Yunus; or 'patient capital' by Founder and CEO of Acumen

Fund, Jacqueline Novogratz - the notion of using private entrepreneurship to tackle poverty and environmental challenges, has ascended rapidly.

Like all private sector markets, the sector requires capital to grow and thrive. In this context, impact investing, which is expected to provide between US$400 billion and $1 trillion in investment assets globally over the next decade, presents a critical source of funding to this sector (Monitor Institute, 2009; JP Morgan, 2010). Impact investing is growing rapidly. In their fourth annual survey of major participants in the impact investing sector, J.P.Morgan and the Global Impact Investing Network (GIIN) found that investors were planning to increase their investments by 19% between 2013 and 2014, from $10.6 billion to $12.7 billion (J.P. Morgan and GIIN 2014).

**Impact investing funds invested by destination during 2011**


Source: IMPACT-Australia (2013) adapted from Y Saltuk, A Bouri and G Leung, Insight into the Impact Investment Market, JP Morgan and the GIIN, 2011

"Impact investing" refers to a practice of investment that intentionally seeks to deliver a positive social and/or environmental impact, in addition to a financial return. In other words, it generates both social and financial 'revenues'. This rapidly developing sector has the potential to unleash large sources of capital for addressing social, cultural or environmental issues.

> *The distinguishing feature of impact investing is the intention to achieve both a positive social, cultural and/or environmental benefit and some measure of financial return…Financial return distinguishes impact investing from grant funding; intentional design for positive benefit to society distinguishes it from traditional investments…Impact investing has emerged against a backdrop of longer term global trends. Interest and activity are evident and growing across the world… Fundamentally, this is about expanding the total pool of economic and social value, not redistributing what already exists. Impact investment is already having a positive effect globally in catalysing new markets and encouraging entrepreneurship and innovation for the benefit of society* (IMPACT-Australia, 2013).

Although currently in relatively nascent stages, impact investing is developing in Australia, and could provide up to $32 billion in the next decade to the domestic market, growing at around the international growth rate of 30% (IMPACT-Australia, 2013). Actors in the Australian marketplace are becoming increasingly active, and patterns are reflecting developments across the globe. Early movers within financial institutions, government bodies, philanthropists and the not for profit sector, have shifted from demonstration cases to active implementation in the field.

Interest in impact investing approaches for international development is also escalating. J.P.Morgan and the GIIN found that 70% of impact assets were invested in emerging markets in 2013, with the greatest increases being investments directed to Sub Saharan Africa and East and South East Asia. Notably, of these investors, 80% were headquartered in North America or Western, Northern or Southern Europe (J.P Morgan and GIIN, 2014). Clearly, there is great potential for a larger role from Australian and Asian-Pacific investors.

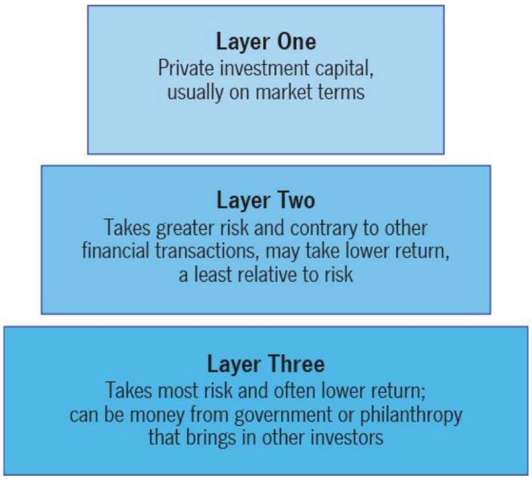
However, not all investment that has a positive impact is impact investment. A broad range of approaches can be encouraged that create investments with impact, particularly in countries where many basic needs remain unmet. Intention and design for impact is what distinguishes impact investment and also what makes it a focus for governments seeking greater effectiveness from their development spending. Some international aid agencies and development banks are currently reviewing their portfolios to highlight their impact investment portfolio; the Overseas Private Investment Corporation has completed this process and published the results on their website.

Utilising impact investment in international development programs carries a number of potential positive outcomes, such as:

- Supporting market-based solutions to economic growth that, at a certain point, become economically independent and self-sustaining.
- Increasing the focus on outcomes and effectiveness by designing for and measuring impact.
- Providing seed capital for positive economic cycles of development: creating jobs and income, to grow businesses, support market growth, and provide tax revenues for reinvestment in infrastructure and the economy.
- Promoting innovation and entrepreneurship in growing markets: supporting low cost/high impact solutions that respond to specific social and environmental contexts
- Developing markets, to promote trade between regions and/or nations
- Increasing the total capital available for investments, for example through creative use of government and philanthropic funding that mitigates risk and creates appropriate incentives to mobilise private capital.
- Leveraging the competencies and expertise of the private sector.
- Creating opportunities for investment to promote growth and efficiency in local markets through investment in enterprise and in distribution platofrms.

Impact investment is delivered in diverse forms, including debt, equity, public-private partnership structures, and hybrid combinations. It involves a mix of investors with different priorities, and appetites for risk and return (on both the social and financial sides).

**Layered Structures for Impact Investing**
SOURCE: IMPACT-Australia, 2013




*Impact investments track many of the existing asset classes in financial markets, including cash, fixed interest, infrastructure and alternative assets…There is also a growing interest in the use of new 'hybrid' mechanisms by government and philanthropy... Impact investments can be flexible. They can also take time to design and negotiate, and may not be suitable in all circumstances* (Australian Department of Employment, 2013).

A feature of a number of impact investments is collaboration between various forms of capital. For example, investments could involve modest amounts of grant or risk-taking seed capital, or loan guarantees in order to facilitate and attract other forms of private investment. Often this 'first layer' capital is sourced from government and/or philanthropy; providing a powerful catalytic role in risk management, and spurring on other sources of investment capital. Examples for how such catalytic and risk-management investments have been made in international aid and development ventures, are provided further below.

Further background on impact investment, its development and importance and the potential to grow the market in and from Australia is provided in IMPACT-Australia: investment for social *and* economic benefit at **Attachment 1**.

## Examples of Structures and Forms of Impact Investing for International Development

### a) Public Private Partnerships and Collaborations

At the core of many impact investments is innovative and productive collaborations between governments, the private sector, and civil society. These hybrid structures, often referenced as public private partnerships have demonstrated great potential to generate blended (social and financial) value. The World Economic Forum notes that:

> *"Impact Investing is a multi-stakeholder issue. It engages governments as impact investments offer opportunities for more efficient delivery of public services. It engages civil society, from the non-profits that design and implement projects to individual recipients of social programmes. And it involves businesses, ranging from entrepreneurs and lawyers to consultants and investors. Clearly, for impact investing to reach its potential, it must be considered from the perspective of all stakeholders"* (World Economic Forum, 2013).

These different stakeholders benefit in various ways from accessing the impact investment sector:

- Social impact entrepreneurs and organisations need access to capital and support in the same way that commercial entities do.

- The mainstream financial market benefits from providing appropriate finance for initiatives and services that create a positive impact in community. The entire social and economic pool benefits from economic development.
- Communities benefit when they can finance new services and infrastructure, and can generate jobs. Increasing the flow of capital into developing economies experiencing persistent joblessness and disadvantage can shift economic and market circumstances towards more positive cycles of employment, purchasing power, and business investment.
- Investors seek choice and new opportunities to put their money to use in ways that make a financial return, benefit society, and respond to shareholder and consumer appetite for corporate responsibility.
- Governments are better equipped to target spending and encourage more private capital into regions where there is need for new solutions and market development.

There are some excellent examples of impact achieved through public private partnerships and donor seed funding for programs in developing countries. For instance, in 2004, the UK Department for International Development (DfID) provided funding to Vodafone to develop mobile banking solutions for the 'unbanked' in Kenya. The initiative famously spurred M-Pesa, launched in 2007, and allowing credit to be transferred between mobile phones, as well as a suite of digital payment facilities. Expansion and uptake of M-Pesa has been extremely rapid, with over 17 million accounts being registered in Kenya in 2012, and several pilots rolling out around the globe.

Government sponsored international aid agencies have also played a pivotal role in developing early institutions to support development of the market for impact investment. For example, both USAID and the UK Department for International Development (DfID) have supported the Global Impact Investment Network in collaboration with private sector partners including JP Morgan and philanthropic foundations like the Rockefeller Foundation and Bill & Melinda Gates Foundation.

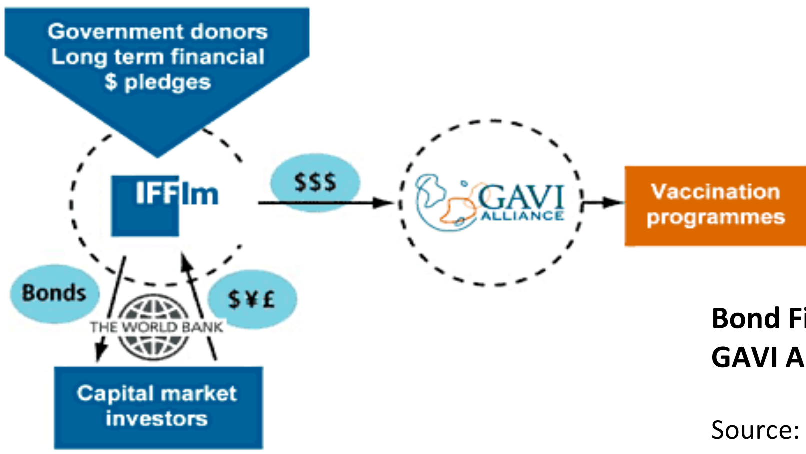
### Case Study: The GAVI (Global Alliance for Vaccines and Immunization) Alliance

GAVI was launched in 2000 to fund vaccines for children in over 70 of the world's poorest countries. The initiative has sponsored over 600 million vaccinations, and is expected it will have prevented over 10 million deaths by 2015.

Initially a collaboration between the World Health Organisation, UNICEF, the World Bank, and the Bill and Melinda Gates Foundation, the program is an innovative approach to foster market-based solutions to vaccine delivery. At the heart of the Alliance is partnerships between the sector to avoid duplication of efforts, and utilise the unique value-adds of each sector. The program is partly funded through the International Finance Facility for Immunisation (IFFIm). IFFIm leverages funding from donor governments, to sell bonds to the financial sector, securing a consistent flow of capital for GAVI programs. IFFIm has raised over $US4.5 billion from capital markets, six times the donor funds received. IFFIm also benefits from US$6.3 billion in donor contributions, including from Australia.

The GAVI Alliance is further supported by the 'Advanced Market Commitment', whereby donors commit funds to ensure the price of new vaccinations once they are developed. Pharmaceutical companies commit to providing vaccinations at an affordable price, and the funding provides the necessary sponsorship to vaccine manufacturers to incentivize their continued to investments in research and product development.

In a complementary addition to these innovative financing structures for global health, in September 2013, a US$108 million Global Health Investment Fund was launched to fund medical research and development. Investments will be directed to a spectrum of initiatives including vaccinations for cholera, HIV, diarrhoea, malaria and TB, as well as nutrition and family planning programs. The investments are managed by Lion's Head, and investors benefit from a partial guarantee of up to 60% of their investments. Sponsors and partners include the Bill & Melinda Gates Foundation, J.P.Morgan, AXA Investment Managers, and the German Development Bank (Global Health Investment Fund, 2014).




**Bond Financing for IFFIm and GAVI Alliance**

Source: IFFIm, 2014

### b) Development Impact Bonds

Similar to Social Impact Bonds in domestic markets, Development Impact Bonds provide an up-front supply of capital to international development from private investors, whose investment (and interest) is then repaid by donors or host nation governments, once mutually-agreed outcomes have been met. Revenue from the Bond is often generated through the cost-savings to the host region of the specific program. Often called 'pay for success' bonds, these financial structures reward successful outcomes, when and if they are met. This provides a useful model in many development contexts where host nations are faced with severe limits to available resources and capital; and many donors fear misappropriation of funds, or inefficient funding.

Potential collaborations of interest may include the Development Impact Bond Working Group, a partnership between the Center for Global Development and UK-based Social Finance, established in June 2013. Owen Barder, Senior Fellow at the Center for Global Development, and a Co-Chair of the Working Group states,

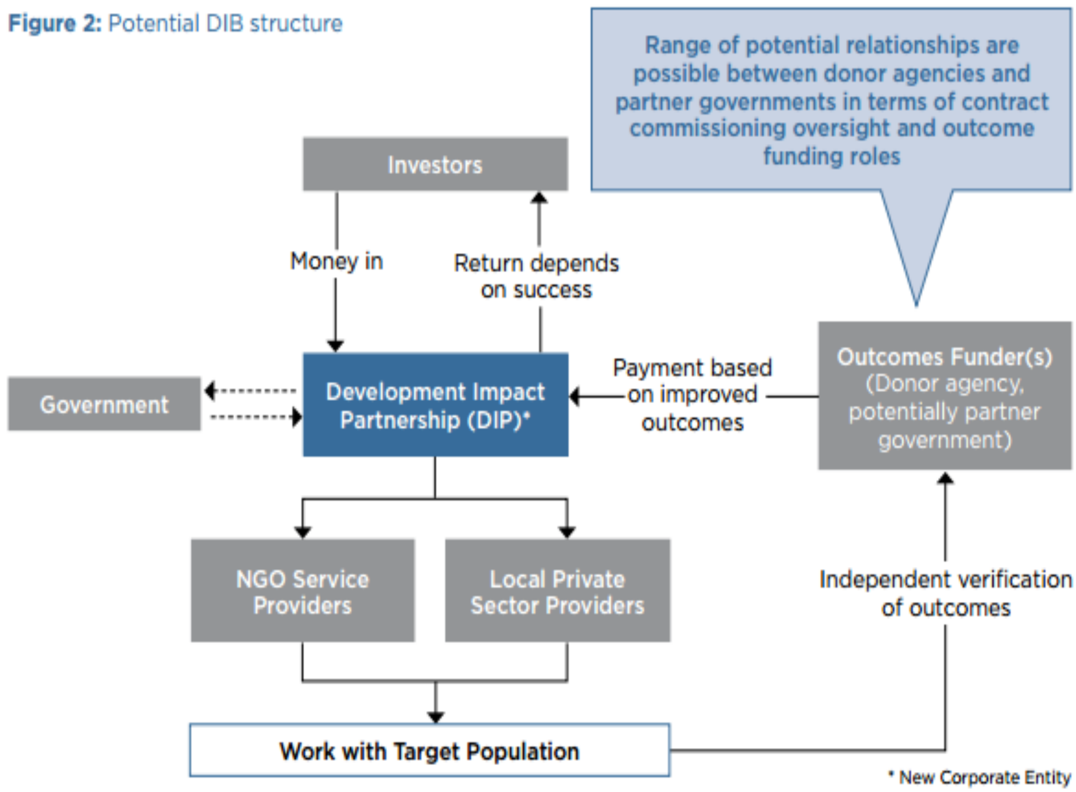
> *"There are exciting times for development finance. Traditional aid is vanishingly small compared with new sources of finance, such as domestic revenues, private investment, remittances, and money from new donors, foundations and private giving. Development Impact Bonds enable different organisations to work together, each making an important and distinct contribution. The*

> *result will be better health, education and other services in developing countries, and more efficient use of scarce development funds"* (Center for Global Development, 2013).

Development Impact Bonds are still in nascent stages, but a number of opportunities exist. For example, the Working Group on Development Impact Bonds outlines various possibilities including countering sleeping sickness; reducing HIV infection through antiretroviral treatment; and energy efficiency programs.

**Potential Structure of a Development Impact Bond (example only)**

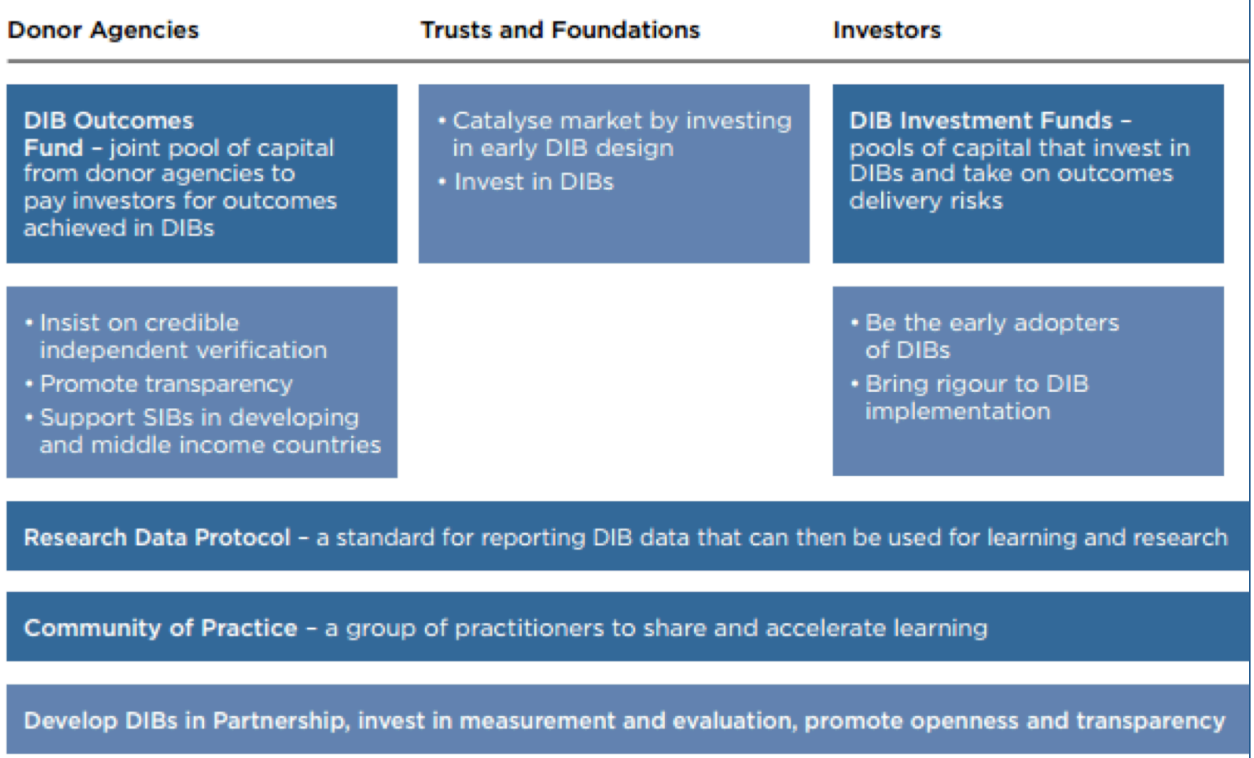
Source: Center for Global Development and Social Finance, 2013




Particularly relevant to this Inquiry is the Working Group's analysis of the potential role for development impact bonds in financing small and medium enterprises (SMEs). For many investors, funding SMEs is costly and difficult. High due diligence costs, and small transaction sizes (usually $50,000 - $500,000) drives up the resource requirements and costs of such investments. Development Impact Bonds which (for example) sponsored a host-country intermediary funding body providing capital combined with business development services, could foster greater supply and demand in the market, as well as stimulate local investment. Performance metrics of the program would be judged on end outcomes (for instance, repayment of loans by SMEs to third party financiers). If outcomes are met, donor governments would remunerate private sector investors for the initial capital (Center for Global Development and Social Finance, 2013).

Other examples of innovative financing structures and bonds for international development present enormous potential for positive impact. For example, some countries such as Israel and India have utilised Diaspora Bonds, where high net worth and other private investors from the diaspora have pooled funding to support infrastructural and other development projects in their home country. Homestrings, working in a similar vein, connects high net worth diaspora investors to investment projects in their home countries. The program partners with home-country governments on developing the selected programs for investment, and outcome measurements. The fund is user-driven, so applicable to many geographical regions, but had an original focus on Africa. Homestrings currently has over 17 investments underway in various sectors, including: healthcare and hospital infrastructure development; agricultural value chain investments; real estate development; and sovereign bonds (Homestrings, 2014).

**Recommendations of the Working Group on Development Impact Bonds: Developing the DIB Market**




Source: Taken from Center for Global Development and Social Finance, 2013.

### c) Loan Guarantees and Risk Management from Donors

Recognising the potential for catalysing private sector investment in developing economies, a number of international donors and philanthropic leaders have provided loan guarantees and other risk-sharing capital to facilitate private investment, for example:

- **USAID's Development Credit Authority:** Provides loan guarantees for investors in more than 70 countries, providing over US$3.1 billion in loan guarantees since 1999. USAID generally guarantees 50% of the total capital invested in projects (USAID, 2013).
- **Overseas Private Investment Corporation, US:** The US Government's OPIC, facilitates private capital from US investors in emerging markets, assisting US companies to develop business operations and markets in countries of interest, while developing incomes, jobs, and revenues in

host countries. OPIC supports investors with a suite of risk-management tools, including financing, guarantees, and political risk insurance. Since its establishment in 1971, OPIC has supported over US$200 billion in investments in more than 150 countries, and is estimated to have generated US$76 billion in exports from the US, as well as 278,000 US jobs. More recently, OPIC launched a program focusing on impact investment, and over the past five years, more than $2.4 billion in funding has been placed in impact investments. OPIC also provides qualified investors the opportunity to invest in fixed income notes issued by OPIC in projects meeting robust social, environmental responsibility standards (OPIC, 2014). In the fiscal year of 2012, OPIC generated net profits of $272 million.

> *"OPIC is the U.S. Government's development finance institution. It mobilizes private capital to help solve critical development challenges and in doing so, advances U.S. foreign policy. Because OPIC works with the U.S. private sector, it helps U.S. businesses gain footholds in emerging markets, catalyzing revenues, jobs and growth opportunities both at home and abroad. OPIC achieves its mission by providing investors with financing, guarantees, political risk insurance, and support for private equity investment funds"* (OPIC Website, accessed May 2014).

- **Alliance for A Green Revolution in Africa (AGRA):** Some impact investors are seeking out innovative market-based approaches to reduce the severe effects of staple food price volatility, increasing pressures of food supply, as well as the resulting global food crises in 2007-2008 and 2011. For example, Standard Bank (Africa's largest bank), committed to lend US$100 million in Africa to capitalise smallholder farms, after receiving a $10 million guarantee from Nairobi-based AGRA. AGRA was founded in 2006 by the Rockefeller Foundation and Bill and Melinda Gates Foundation.

### d) Donor-Supported Funds for Impact Investing in International Development

A number of international donors have established, or contributed to, funds seeking to catalyse investments into the private sector in targeted developing countries. Various funds are structured in different ways, and target different sectors and/or geographic regions. Carefully implemented, they have the potential to generate great positive impact by: providing seed capital for businesses who often cannot access mainstream commercial capital; facilitating wide-spread market development through catalysing large 'knock-on' effects of market development and job creation; and augmenting the overall impact of capital and resources injected into projects (as capital may be returned and recycled, after exiting various funds). Examples include:

- **DfID Impact Fund:** In December 2012, the UK Department for International Development (DfID) launched a £75m (~AUD$134 million) Impact Investment Fund to catalyse impact investing markets in sub-Saharan Africa and South Asia. The Impact Fund, supported by expert technical assistance, will be directed to intermediary funds with a robust strategy for investing in businesses with a positive impact on the 'bottom of the pyramid'. By investing 'patient capital' in these companies, the fund provides capital to businesses that are normally excluded from mainstream investment and commercial development. Expected outcomes of the Fund include investment in more than 100 enterprises in sub-Saharan Africa and South Asia, and ensuring additional private capital is invested to complement the Fund (DfID Impact Fund, 2013). The Fund is managed by CDC, the UK's Development Finance Institution, established in 1948 and wholly owned by DfID.

- **African Agricultural Capital Fund (AACF):** In September 2011, the AACF, a US$25 million fund was closed by the Gatsby Foundation, Rockefeller Foundation, Bill and Melinda Gates Foundation, JP Morgan, and USAID. To facilitate the fund, USAID provided JP Morgan with a loan guarantee of 50%. The fund is managed by Pearl Capital Partners, which seeks to invest the fund into small and medium sized agricultural enterprises in East Africa. The Fund also includes a formal impact measurement committee to evaluate the social and financial outcomes of the investment, utilising the Impact Reporting and Investment Standards (IRIS) mechanism of the Global Impact Investment Network (GIIN). The Fund seeks financial returns of around 15% across the portfolio, with investments of between $200,000 - $2.5 million. AACF targets include improving livelihoods of at least 250,000 smallholder farmer households within five years.
- **USAID Development Innovation Ventures (DIV):** invests in ground-breaking entrepreneurial models with potential for social impact. The fund represents over $40 million earmarked for cost-effective and sustainable innovations. Launched in 2010, the initiative has funded 88 innovations, at an average investment of $700,000 each. Emphasis is placed on funding proof of concept and scaling phases (USAID Development Innovation Ventures, 2014).
- **Global Development Innovations Ventures:** modelled on the above DIV, the GDIV is a partnership of USAID and DFID, launched alongside the G8 Social Impact Investment Taskforce in June 2013. The initiative plans to build a global investment platform to support solutions to complex development challenges. GDIV incorporates a competition for investments; an evidence driven investment strategy; and developing a marketplace for development successes.

A range of other private funds and organisations exist to provide financing and growth capital to the private sector in developing economies. These organisations (some with an operating presence in Australia) provide a wealth of experience and knowledge on impact investing for international development that could be utilised by DFAT and other stakeholders. For instance:

- **Leapfrog Investments:** (headquartered in Australia) invests in high growth companies in Africa and Asia, with a portfolio reaching over 18 million people. LeapFrog is funded by some of the world's largest institutional investors, such as JP Morgan, Prudential, Swiss Re and TIAA-CREF. LeapFrog invests in companies that provide access to financial tools such as insurance, credit, and savings.
- **Unitas Impact:** invests in scalable businesses in Asia's fastest growing markets that engage the working poor as suppliers or distributors. Unitas focuses on improving supply chain efficiencies and creating innovative distribution platforms in early stage companies in India and Southeast Asia, particularly Indonesia and Vietnam.

## Facilitating Impact Investment from Australia, and the Role of DFAT and the Australian Government.

Impact investment is emerging from existing institutional contexts, including established capital markets and the philanthropic sector. However, there are limits to what can be achieved by these established sectors without a supportive enabling environment. The private market alone does not fully promote, and sometimes may even prevent, investments with social or environmental benefits. However, literature suggests that private markets can be an appropriate tool to address particular social and environmental challenges (Thornley et al, 2011; Eggers and Macmillan, 2013). There is an active and critical role for government to play in shaping policies that reduce duplication in the sector, remove barriers to sector engagement and capital, and facilitate private capital.

Research points to collaboration between public and private sectors as a key success factor for the best performing impact initiatives.

> *Impact investors and policymakers increasingly realize that they share common goals and that each has something powerful to contribute in achieving these goals. Governments are recognizing that social enterprises can offer sustainable and effective solutions to social and environmental problems; investment practitioners are becoming more conscious of the opportunities to engage with policymakers, and the risks of not doing so* (Impact Investing 2.0, 2012).

> *Impact investors cannot afford to ignore critical political considerations. Enlightened politicians and policymakers have the potential to dramatically speed up the rate at by which an industry can scale to responsibly serve hundreds of millions. Conversely, when impact investors fail to align with policymakers, we will find ourselves at risk of double jeopardy. We can fail because the companies we invest in may have a hard time growing in the most challenging of markets. Or we can fail because these same companies may eventually be seen as too successful and profitable—inviting a powerful and potentially destructive backlash from public opinion, threatened incumbent commercial interests and/or politicians* (Bannick and Goldman, 2012).

This collaboration also plays a significant role in ensuring that policies to promote private sector engagement foster sector development

> *Creating and scaling entire sectors can make the difference for example, between supporting one solar lantern company that can provide safe lights to thousands of children who otherwise can't study for school at night – and accelerating an entire solar lantern industry that could provide these lanterns to millions, if not hundreds of millions of students (*Bannick and Goldman, 2012).

The cases above highlight only a small sample of the types of innovative and impactful models that might be applied to promote private sector development in international development programs. Impact investing is not a silver bullet, and its applicability, relevance, and outcomes, must be carefully considered for each context. However, much can be achieved. In current policy environments of great need, and limited capacity, impact investing presents a viable option to support significant positive impact for Australia's key regional and strategic interests.

There is an important role for government to play in facilitating impact investments from Australia.

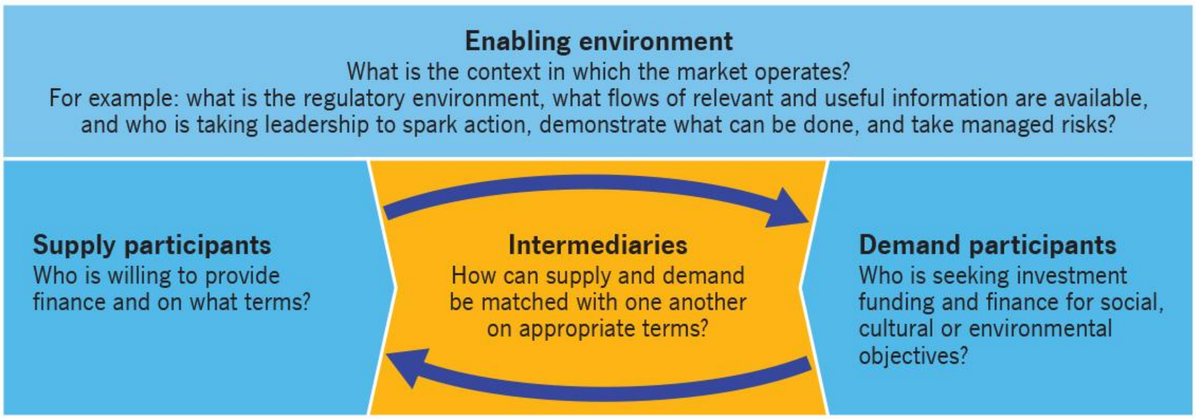
Like other parts of the financial system, impact investing operates within the framework of a marketplace and that marketplace operates locally and globally. The marketplace is shaped by those seeking and those supplying capital, but also by the regulatory environment, and the availability of relevant and useful information.

Promoting impact investing will require government bodies to foster effective collaboration within and between, various sectors of the market.

> *Without supply of capital, investments cannot occur. Without robust propositions and organisations in which to invest that actually produce impact and returns, capital will not enter or*

*remain in the field. Without people and structures that facilitate supply and demand coming together within acceptable frameworks for all parties, many impact investments simply will not happen* (IMPACT-Australia, 2013).

**Market Dynamic for Impact Investment**




SOURCE: IMPACT-Australia, 2013

There is a role for government alongside other actors to encourage flows of capital and enterprise development. Governments' role as regulator and legislator is important; and the suite of policy levers used to shape markets, create disincentives for harm, and influence where capital is directed, all have application in the context of impact investment.

*Government intervention can play a catalytic role both in facilitating the functioning of the ecosystem and targeting actions to trigger its further development. However, these actions should provide incentives for the engagement, not the replacement, of the private sector and should be conducted in a manner conducive of the market* (OECD *Policies for Seed and Early Stage Finance: Summary of the 2012 OECD Financing Questionnaire,* 2013).

Governments have a role as catalyst and aggregator of resources and can be effective as both a market participant and condition setter:

- **Market participant:** Identifying opportunities to more effectively target and leverage public spending by attracting private capital; and
- **Facilitator of market development:** Stewarding and catalysing the field to encourage the market to grow, enlarging the pool of capital seeking to achieve positive benefit for society.

In the short to medium term, some government investment can catalyse the market, reduce risks for new entrants, build track records, and enhance investor confidence. Internationally and in Australia, there is a track record for government action underpinning the emergence of growing and new industries. In Australia this has included venture capital, research and development, green and renewable technology, and business model innovations for structural adjustment.

There is a clear policy opportunity for governments to develop a strategic approach to building the market for these investments from Australia. International and local evidence demonstrates that government leadership, including relatively modest and targeted policy initiatives (including repurposing existing spending), can have a significant positive impact on catalysing market activity. The objective should be to:

- Provide leadership that signals interest and legitimacy, giving more actors confidence to participate
- Contribute to the development of market infrastructure that will develop the frameworks and systems that encourage and enable more capital for social purpose
- Leverage private capital in targeted policy areas to demonstrate efficacy and improve outcomes.

In the international development context, the communities and partnerships already active between governments, and new opportunities for collaboration can be utilised to create opportunities and efficiencies of scale.

## Leveraging Recent Developments in Australia and Internationally

Impact investing has been rapidly gaining interest and momentum across the globe. Recent developments present a unique opportunity to capture this drive, and catalyse significant impact.

> *The trend lines reveal a confluence of factors: decreasing government expenditure and greater emphasis on evidence based interventions, growing consciousness among investors and a new generation of talented social entrepreneurs who are pushing boundaries and developing disruptive solutions. This points to a window of opportunity that cannot and should not be missed* (Schwab Foundation, World Economic Forum et al, 2013).

Work is underway to accelerate this development of impact investment globally. An international Social Impact Investment Taskforce (the 'International Taskforce'), was established by the G8 in 2013, and announced by PM David Cameron at a Forum in London, UK, last June. The Taskforce is Chaired by Sir Ronald Cohen, an international leader in the fields of both impact investment and venture capital. Membership is drawn from G8 countries (excepting Russia) and Australia is the only country outside the G8 and EU currently invited to participate. **Attachment 3** includes a list of members of the International Taskforce and background on its work.

The primary aim of the International Taskforce is to galvanise development of an effective global social impact investment market. The International Taskforce will report in September 2014. That report will be informed by research being undertaken by the OECD and inputs from four key working groups. International development is a priority and the focus of one of the four working groups; the others relate to measurement, asset allocation, and mission alignment. Of particular interest to this Inquiry will be the working group on international development, Chaired by Ms. Sonal Shah, for which a biography is included in **Attachment 2**.

A number of other initiatives to promote greater cohesion and collaboration in development finance were also rolled out following the G8 Social Impact Investment Forum in London. Of particular relevance is the Development Finance working group (additional to the Taskforce work) and in October 2013, 25 development finance institutions, including OPIC, the Asian Development Bank, CDC Group, International Finance Corporation, Multilateral Investment Guarantee Agency, and the Inter-American Development Bank signed a moratorium to harmonise measurement of social impact, and increase collaboration. A copy of the outcomes of the G8 Social Impact Investment forum is provided in **Attachment 6.**

The opportunity to act now is linked to Australia's participation in the Taskforce, and its role leading the Global Learning Exchange initiative, convened by the World Economic Forum, UK Cabinet Office, and Impact Investment Policy Collaborative. This will promote an action oriented agenda with international networks and experience to accelerate developments in Australia.

An Australian Advisory Board has been established, bringing together leaders from across sectors. The appointment and role of the Advisory Board is aligned with the structures now in place in all participating countries under the governance adopted by the International Taskforce. The intention is to utilise links to the global work to elevate issues and action in a way that builds longer term capability, engagement and momentum locally. This picks up on the key recommendation of the Senate Economics References Committee in 2011, for leadership to provide dedicated focus and attention to the development of the market for impact investment in Australia (see *Investing for Good,* Recommendation 2.1, 2011). **Attachment 4** includes a list of the members of that Advisory Board and a copy of its Terms of Reference.

The primary roles of the Australian Advisory Board has two key planks:

- Provide inputs to the International Taskforce process; and
- Provide leadership in the Australian context for development of the market.

Its work is being informed by a robust process of engagement with practitioners and stakeholders in impact investment in Australia. An objective of the engagement process is to contribute to the development of priorities for action and inform the development of a work plan to contribute to local market development.

Subject to resources, it may be feasible for DFAT, and other bodies of the Australian Government, to collaborate with this Advisory Board and its Secretariat in exploratory or implementation partnerships to facilitate impact investing in the Indo-Pacific region.

## Recommendations

The following recommendations are made as practical examples for how DFAT and the Australian Government might move forward in this area:

***Sector capacity:***

- Conduct further analyses, with contributions from leading stakeholders and practitioners, on the most relevant forms of impact investment structures for economic growth and poverty reduction in the Indo-Pacific region. This may include mapping and consultation with private sector models in the region, to understand available infrastructure and frameworks.
- Invest in sector and market building capability for the region with support for institutions that can extend the range of actors participating, and position Australia as a hub for private sector development investment into the region.
- Identify a small number of impact or outcome areas (by sector) on which to focus efforts, and facilitate partnerships with the private sector.

- Investigate application of fit for purpose impact measures to assess social and financial impacts of investments. This could be linked with the work underway pursuant to the Memorandum of Understanding mentioned above.
- Explore ways in which information and data held by DFAT and other government departments regarding development issues and outcomes can be shared more broadly to encourage more effective measurement and targeting of international development programs.
- Create facilities and mechanisms for information sharing, both within and between departments of Government, as well as with external parties with a particular focus on impact measurement, risk management, scaling solutions and what works.

***Facilitate partnerships***

- Engage strategically in the extensive work underway at the global level to generate an impact investing marketplace, with specific reference to international development. Potential partners would include other aid agencies and development institutions already working with the private sector.
- Appoint a representative within DFAT and/or other relevant Government departments who can become a point person for the sector, and coalesce various stakeholders (both internal and external to the Australian Government) around impact investing activities and funds in the Indo-Pacific.
- Use an expression of interest process to solicit the best of ideas and interest from private sector in targeted impact areas with a view to developing the most successful ideas in collaboration with the private sector and other interests including relevant development agencies and local communities.

***Support development of innovative financing tools, including those that manage risk for the private sector***

- Conduct feasibility on an Overseas Private Investment Corporation approach for Australia with a particular focus on markets in the Asian and Indo-Pacific regions.
- Identify impact areas where an outcomes based approach to funding could be employed with the specific objective of leveraging private sector resources.
- Re-orient some existing aid funding to provide first loss seed capital for an Impact Fund for International Development, that could target geographic and/or sector focus, leveraging significant available design and performance lessons learned and experiences of other international funds for development
- Explore options to provide other short to medium term catalytic incentives to encourage and develop appropriate intermediation such as initiating some pilot investments in the Indo-Pacific, which can then be replicated and/or scaled, potentially to additional countries and/or sectors.
- Provide risk capital or other risk reduction mechanisms to attract appropriate investment in small and medium size enterprises in priority Indo-Pacific regional communities.

- Explore options in development bonds. As highlighted in this paper, there are a number of pilots underway in this area. Others are emerging across sectors, and extend from health and education, to road safety bonds. Added to programs underway in the Australian domestic context (e.g. two Social Benefit Bonds in NSW), there is good capacity to partner with local expertise.
- Support capacity for local companies and enterprises in the Indo-Pacific as well as Australian investors and corporates to engage in impact investing models.
- Explore options to better utilise the corpus of philanthropic trusts and foundations in international development programs, including adaptation for Australia of mission and program related investment regimes in other jurisdictions. This would assist in mobilising sources of risk capital other than government funding.

## Conclusion

Impact investing is an important component in the role of the private sector in supporting economic growth and poverty reduction in the Indo-Pacific region.

Internationally, strong progress is being made to facilitate a greater role for the private sector in international development. As the small sample of case studies illustrates, countries to which Australia often looks to benchmark policies have adopted a development investment approach with a significant focus on encouraging and facilitating private engagement, and there are a range of innovative partnerships between governments, the private sector, and international development organisations emerging across geographies and sectors. International donors and the private sector are engaged in rolling out a variety of tools including development impact bonds, new investment funds, loan guarantees, enterprise and sector development, and infrastructure. Government also has a critical role to play in catalysing the impact investing sector, particularly through managing and mitigating risk for the private sector.

There is already increasing focus in Australia on impact investing, particularly in the domestic context. There is significant potential to facilitate a greater role for the private sector in fulfilling Australia's international development objectives and create opportunities for growth, promoting export markets, and augmenting trade and economic growth in geographic regions of great strategic interest to Australia.

The opportunity for DFAT is to develop a positive agenda to simultaneously encourage private sector engagement; develop a range of tools for sustainable development funding in line with objectives such as the Millennium Development Goals; target the effectiveness of development aid; boost enterprise and capacity in the Indo-Pacific; enable new distribution channels for private enterprise and local innovation; enhance growth markets in exports; and increase regional stability through economic growth.

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**ATTACHMENTS:**

- **1: IMPACT Australia Report**
- **2: Potential Advisors/Stakeholders of Interest**
- **3: International Social Impact Investment Taskforce**
- **4: Membership & Terms of Reference of the Australian Advisory Board**
- **5: About Impact Investing Australia**
- **6: G8 Social Impact Investment Forum Outputs and Agreed Actions**

IMPACT Investing AUSTRALIA

## ATTACHMENT 2: Potential Advisors/Stakeholders of Interest

### Sonal Shah, Professor of Practice and Founding Executive Director of the Beeck Center for Social Impact & Innovation

Sonal Shah is Professor of Practice and the founding Executive Director of the Beeck Center for Social Impact & Innovation. Sonal, an economist and entrepreneur, has spent her career focused on actionable innovation in the public and private sectors. Most recently, she was the Deputy Assistant to the president and founding Director of the White House Office of Social Innovation and Civic Participation. She spent seven years at the U.S. Department of Treasury where she was an international economist working on timely development issues, including post-conflict development in Bosnia, Asian financial crisis and poverty reduction in Africa. She then went to Goldman Sachs and Google while simultaneously co-founded Indicorps, a nonprofit building a new generation of socially conscious global leaders. She is a senior fellow at the Case Foundation and the Center for American Progress. Sonal serves on the Board of Social Finance, Inc. and the Washington Area Women's Foundation.

### Mitchell Strauss, Special Advisor, SRI Finance, OPIC

Mitchell Strauss has served as the Special Advisor on SRI Finance with the Overseas Private Investment Corporation, for over 17 years. She was previously the Executive Vice President at Riggs Bank between 1979 and 1993.

## ATTACHMENT 3: BACKGROUND ON THE INTERNATIONAL SOCIAL IMPACT INVESTMENT TASKFORCE

### MEMBERS OF THE INTERNATIONAL SOCIAL IMPACT INVESTMENT TASKFORCE

| | |
|---|---|
| SIR RONALD COHEN (UK) (Chair) | Big Society Capital and The Portland Trust |
| KIERON BOYLE (UK) | Cabinet Office |
| MATT BANNICK (US) | Omidyar Network |
| DON GRAVESJONATHAN GREEMBLATT (US) | US Department of Treasury/White House Office of Social Innovation & Civic Participation |
| HUGUES SIBILLE (France) | Crédit Coopératif |
| CLAUDE LEROY-THEMEZE /NADIA VOISIN (as alternates) (France) | Ministry of Economy and Finance/ Ministry of Foreign Affairs |
| BRIGITTE MOHN (Germany) | Bertelsmann Foundation |
| SUSANNE DORASIL (Germany) | Ministry for Economic Cooperation and Development |
| GIOVANNA MELANDRI (Italy) | Uman Foundation |
| MARIO CALDERINI /MARIO LATORRE La (as alternates) (Italy) | University of Turin Politecnico/ Sapienza University, Rome |
| JAPAN TBA | |
| PETER BLOM (EU - OBSERVER) | Triodos Bank |
| ULF LINDER (EU - OBSERVER) | European Commission |
| ROSEMARY ADDIS (AUS – OBSERVER) | Impact Strategist; Impact Investing Australia |

An International Social Impact Investment Taskforce established by the G8 in 2013. This initiative was announced by PM David Cameron at a Forum in the UK last June. The Taskforce is Chaired by Sir Ronald Cohen, an international leader in the fields of both impact investment and venture capital. The primary aim of the International Taskforce is to galvanise development of an effective global social impact investment market. Each G8 country (except Russia) is represented on the Taskforce by a government official and a senior figure from the world of finance, business, or foundations.

The International Taskforce's work is informed by working groups on impact measurement, asset allocation, development finance and mission integrity, each made up of global leaders in the respective areas, and research by the OECD. The International Taskforce members are supported by a national Advisory Board composed of leaders from the social impact investing field in the jurisdiction. The International Taskforce will report publicly in September 2014.

Australia has been asked to participate for several reasons: the strength of impact investment initiatives undertaken here; and the contribution being made by those involved in establishing Impact Investing Australia Ltd to leading market development locally and globally. Also because it is intended that International Taskforce and initiatives launched at the G8 Forum ought to be the start of greater global engagement, including through the G20 and other international fora. This provides a great opportunity to significantly advance the social impact investment market globally and open up local opportunities forward for what can be achieved in and from Australia.