KFW DEVELOPMENT RESEARCH

Development in Brief

One Pager

No. 26, 15 July 2015

Impact investment – New money for development?

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The term impact investment was coined in 2007 by the American Rockefeller Foundation and describes investments which have financial and ethical objectives at the same time. Ethical objectives include, for example, the reduction of poverty (for instance creating employment opportunities and improved access to social and economic services, specifically for the poor), food security or contributions to environmental and climate protection (e.g. reduced CO2 emissions). These effects are documented and measured.

Impact investors strive to preserve invested capital and usually also a certain but often lower-than-market return. There is now a wide range of markets in different regions and sectors for potential impact investors, with various financial instruments and risk-return profiles. The term "impact investment" overlaps with other value-oriented investment strategies such as development finance, sustainable investing, responsible finance, social enterprise, inclusive business, etc.

Target markets for impact investment are industrialised countries, as well as emerging and developing countries. Common subjects for impact investments include the funding of microfinance institutions ("access to finance" for poor target groups), the provision of affordable housing (social low-cost housing) or the use of environmental and resource-saving technologies (often in the energy sector).

Booming market but no clear definition or quality standards

The fact that there is no uniform and distinct definition for impact investments contributes to the fact that even though the range is wide, it is also difficult for investors to manage. There are no uniform standards for measuring and verifying the achieved effects (impacts) either. Missing data, long results chains and complex interdependencies complicate data capture further. Overall, comparing different offers for potential impact investors is possible only in part. Figures on the quantitative development of impact investments must therefore be interpreted with caution.

The annual Impact Investor Survey by Global Impact Investing Network and investment bank JP Morgan provides the most detailed information on this market segment just now. The definition of impact investment within the survey is relatively broad. However, small investors and individual investments under USD 10 million are not included. The 145 impact investors surveyed (fund managers, banks, development banks, foundations and pension funds) invested USD 10.6 billion in the area of impact investments in 2014. They are planning a further increase in the investment volume for 2015 by 16%. Overall, the respondents manage impact investments amounting to USD 60 billion (35% own capital and 65% customer capital). The majority of the investments in 2014 were made directly in companies (74%). The main industries were residential construction (27%), microfinance (16%), other financial services (11%) and energy (10%). Approximately 50% of the investments were made in developing countries.

Potential of impacting investing for development finance

Developing countries offer a wide range of economic investment opportunities with ethical impact claims. So far, this has primarily been a field for mostly governmental bi- and multilateral development finance institutions, which also count as impact investors.

Development finance institutions invest both public and their own funds, but they also collect money as capital market investors (e.g. via the issue of bonds) and provide co-financing options for investors (e.g. via structured funds). Thus they divert resources towards projects with a useful developmental purpose. Development institutions can promote impact investments indirectly too by focusing on improving sectoral framework conditions for private investment for instance, supporting social entrepreneurship, or inputting their experience as well as instrumental, sectoral and regional structuring knowledge.

If further investors are attracted to the impact investment segment, development institutions could extend their commitment to other segments, there are still financing gaps due to increased (anticipated) risks or lack of information.

Conclusion: broad but limited potential

New investors and additional private funds are being mobilised for development finance purposes through impact investments. While the majority of the capital market does not act in a value-oriented way, and instead strives to maximise profits, impact investments offer investors voluntary value guidance. Impact investments represent a small but rapidly growing part of the capital market. Whether impact investments can improve the perception of responsibility on the capital markets on a large scale is still unclear. Investors often need to forego profit. At any rate, what is positive is that impact investments make it clear ethical and microeconomic goals can go "hand in hand". Overall though, we should stay realistic: many investments that make developmental sense are not microeconomically viable, and therefore not suitable for impact investments. ■