Building an Impact Investing Business that Makes a Real Difference

How one of the world's largest asset managers is experimenting with a unique impact investing model in Asia.

Responsible investing is all the rage. By some estimates, one in every four dollars under professional management today was invested under a socially responsible investment (SRI) strategy. The simplest form of SRI aims to generate competitive financial returns and positive societal impact by screening out "sin" sectors such as gambling, tobacco and guns and focusing on those considered a priority for social impact, such as healthcare and clean energy. A more sophisticated type of responsible investing is Environmental, Social and Governance (ESG) investing, which assesses ESG risks and seeks ESG opportunities to help improve a company's long-term, risk-adjusted financial returns.

Impact investing goes a step further, with investments having a clearly defined intentionality for achieving a measurable impact, while at the same time targeting financial returns that range from at least preserving the principal to matching or even exceeding mainstream market returns. Unlike SRI or ESG investing, which generally focus on reducing negative externalities a company generates, impact investing seeks to invest in enterprises that are likely to deliver a net positive impact. Depending on the nature of the investment, impact investors may aim to make this positive difference in diverse ways – such as creating jobs or serving low-income customers through inclusive finance, affordable housing, high-quality education or accessible healthcare.

The extent of cumulative assets under management in impact investing – estimated to be in the range of US$200 billion dollars globally, depending on exactly how this space is defined – remains tiny compared to the tens of trillions of dollars sloshing around in SRI or ESG funds. Part of the challenge is the gap between the large amounts of capital at traditional asset managers that could in principle be available and the relatively limited number of impact investment opportunities that seem credible in terms of delivering risk-adjusted market returns. At large asset managers, there is also a lack of expertise in the nuances inherent in impact investments, which can range from inner-city schools to farms, far removed from traditional investing and the kind of business models they are used to. In the specific context of Asia, although there is a vast pool of social enterprises, a large majority of these still seek relatively small amounts of funding and employ business models unattractive to mainstream investors which are unwilling to accept financial compromises.

An experiment at Credit Suisse

Although large global banks are increasingly jumping on the impact investing bandwagon, critics of a non-concessionary approach often criticise them for having little "additionality" in terms of a unique contribution to generate a meaningful social impact. However, it is not easy for banks focused on scale and competitive market returns to also build an impact investing fund closely connected with making a real difference on the ground. Nevertheless, an encouraging case of the possibility has recently emerged at Credit Suisse (CS). In December 2016, the bank closed a US$55 million impact fund focused on impact opportunities in Asia, and has already invested a significant fraction of this money in seven small- or medium-sized enterprises (SMEs) that are trying to make a positive difference in the lives of so-called base of the pyramid (BOP) populations. Leveraging this experience, it now has plans to launch a second impact fund within a year or so due to popular demand.

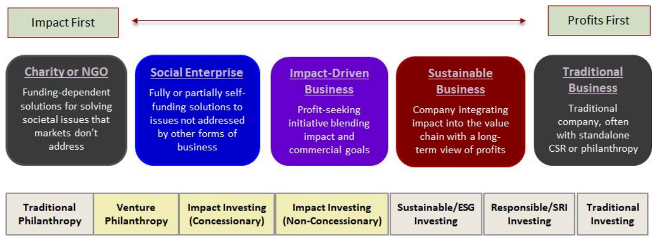
I had the opportunity to work with Joost Bilkes, the Head of Responsible and Impact Investing for Asia Pacific at CS, for a recent INSEAD **case study** to understand how the bank, one of the world's biggest fund managers, is trying to make a meaningful impact on the ground without imposing a financial burden on the bank's balance sheet or compromising on the market returns its clients generally expect.

Defining your place on the intentionality spectrum

Over the last 15 years, CS has built an impressive impact investing platform with over US$3 billion of assets under management. Bilkes was keen to build upon this momentum with a unique approach tailored to Asia – where a large fraction on the global BOP population resided. Serving in Wealth Planning Services under Bernard Fung, CS's head of private banking, Asia Pacific, Bilkes sought to bring access to finance in parts of Asia where SMEs making a meaningful social impact didn't have access to investment capital and cutting-edge management expertise. But building an initiative around this within CS required working within the existing investing metrics and frameworks. In other words, even though Bilkes cared a lot about the social impact generated, he knew he had to make a "business case" for launching the fund he had in mind. As he told me recently, "I can only raise a good amount of money with a good investment product."

Bilkes noticed that across Asia not many funds financed expansion capital opportunities in the US$2-10 million range. But these were not the size of deals CS was used to working with. He realised that any Asia-focused impact fund would need to be compelling from a traditional portfolio theory point of view, meaning scalable and attractive risk-adjusted financial returns. Impact investors should make an honest decision about where an organisation should sit on the impact intentionality spectrum. To justify the launch of such a fund at a bank like CS and achieve scale, Bilkes knew the focus would have to be on a non-concessionary impact investing model based on creating "shared value", rather than pursuing concessionary investment opportunities involving a compromise on financial returns.

The Intentionality Spectrum



Partnering for impact

Bilkes won support from management to build a team to look into impact investing in Asia in 2014. But as he explained, "it was very clear the funding gap, the type of businesses we wanted to allocate capital to were the smaller of the smaller companies. That automatically meant that we had to start with a smaller size investment vehicle." The challenge, of course, was ensuring it was financially viable within a premier bank like CS. As long as he could make the numbers add up in terms of viability, Bilkes was confident that he could justify the small fund as a stepping stone for much bigger opportunities in the future.

Investing in Blueberries

One of the Asian fund's investments was in a Chinese company engaged in the production and selling of blueberry seedlings, fresh and frozen blueberries and deep-processed blueberry products. The company's operations spread across the value chain from cultivation to branding and marketing. CS saw two parts of the company's story that met its impact investing mandate. First, the blueberry is one of the highest value crops in the country. Secondly, the company was well-placed to improve the likelihoods of farmers in poverty by teaching them how to grow blueberries and also providing a market for them. It also presented financial opportunities, given the increasing consumption of blueberries in China.

The target company, which developed a specific blueberry seedling that could survive in rural China, operates in areas primarily considered in poverty areas as specified by the government. In many of these places, staple crops like rice are insufficient to support families and their needs.

Parents often leave the rural areas for factory work in the big cities, "leaving behind" spouses and children. The company re-purposes barren farmland that fails to yield rice or tea crops and aims to help farmers cultivate a high value crop and improve livelihoods.

"If it would just be for a couple of farmers in the vicinity of Shanghai that are already quite well off, then it wouldn't be an interesting opportunity for us," Bilkes said. "From assessment, we found that the incomes would rise by a minimum of about eight times for local farmers. That's what really brought us through to go into due diligence and get into the nitty gritty." A business case for being more inclusive in terms of working with poorer farmers from more remote areas could be made on two dimensions. First, the cost of procurement from such farmers would be much lower. Second, such a model would be much more scalable as a commercial business.

The deal's metrics focused on bringing seedlings and "capacity building" to these farmers to improve livelihoods with a higher value crop than other typical products grown by farmers in China, such as rice. "The sales channels, the access, the route to market, are the most important things we see in every deal we do", Bilkes said.

That's when Bilkes and his team formed a partnership with an Asian venture management group focused on regional growth stage investments to manage the fund. With the partner managing the routine aspects of private equity investment in SMEs, CS could focus on playing the role of "impact adviser". In addition to allowing the fund to operate efficiently, the unique partnership model was also beneficial for two reasons. Firstly, the group was affiliated with a major regional bank with branches all over Asia – providing access to over 500 SME transactions a year, a source of potential impact investments. Secondly, it would also conduct thorough due diligence of potential opportunities just like any world-class venture capital firm would, including sector-specific considerations such as market potential and competitive landscape, as well as company-specific factors such as sources of competitive advantage and quality of management teams. This model also bridged the gap between large institutional capital and on-the-ground knowledge needed for a firm like CS to make a meaningful impact in a way that was also financially viable. Bilkes and his team monitored and evaluated each investee's social performance and their strategy in order to offer potential improvements.

Bilkes was mindful that CS had to stick to its impact-related goals in a disciplined way. He stressed that CS and its partner looked at things in a "pure way" in that the investee companies had to be a profitable business addressing large social and environmental issues. "That's very different than many investments you see today that are maybe branded as impact investments whereby it's a nice-to-have," he said. His fund is also geographically disciplined, focused on China and selected ASEAN countries such as Indonesia, the Philippines, Thailand, Vietnam, Cambodia and Laos. Unlike most managers of large funds who rarely have deep knowledge of what happens on the ground in their investee companies, Bilkes spends a lot of his time in the field – remaining closely connected not only to the investee managers and employees but also their broader set of stakeholders like customers, suppliers, communities and government officials.

Intellectual capital essential

CS's approach in Asia enables it to build up what Bilkes calls a unique "intellectual property" in impact investing. In addition to thorough due diligence of top investment recommendations, CS also circulates comprehensive "investment memorandums" to members of the investment committee, whose approval is necessary before any deal could be finalised. In addition, the team also works with leading experts who have in-depth knowledge related to achieving social impact in the context of a particular sector or region. Bilkes views this intellectual property as something that will ultimately provide a major "competitive edge" for CS, given that it is building structuring capabilities, asset management capabilities and experience working with entrepreneurs on the ground in impact-related areas.

The first investment by the fund was in a nutritional supplement manufacturing company in China, providing supplements to infants in poverty-stricken districts across the country, targeting conditions like child **stunting**, anaemia and general malnutrition.

Another of its investments was in a fertiliser company in one of southern Vietnam's poorest provinces. The company has developed controlled-release 'smart' fertilisers, which reduce greenhouse gas emissions associated with rice cultivation by 80 percent, while increasing yields by 20 percent, resulting in higher incomes for poor farmers.

Given that its first fund is a seven-year private equity fund, it has not yet made any planned exits, but Bilkes is keen to make sure exits are also tied to both financial and social outcomes.The fact that a major bank like CS is interested in this area, albeit still a nascent industry, is an encouraging development. Connecting the dots between high finance and the boots on the ground has been a difficult gulf to bridge for impact investing to grow in a meaningful way. **Developments at CS** indicate further commitment to the area, with the creation of a new impact advisory and finance department, reporting directly to CEO Tidjane Thiam.

Replicating what CS has done is not attractive for anybody seeking to quickly make big bucks by jumping on the impact investing bandwagon. But I believe that the long-term perspective and patience CS is demonstrating would likely pay off well in the future, especially as investors are increasingly asking not just about risk-adjusted returns but also the societal impacts their investments generate. Over US$1.2 trillion of money sits in various CS client accounts around the globe, and developing expertise in the social impact arena would serve the bank particularly well as this investable wealth gets passed on to the next generation of leaders – who many studies show care about societal issues far more than the current generation does.

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