<u>Media release</u>

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What every CEO needs to know about impact investing

As a business leader the term impact investing is probably cropping up more regularly in your board room discussions especially in conjunction with debates about your corporate social investment approach or your company's social responsibility.

Awareness about this symbiotic "marriage" between social and environmental impact, as well as financial returns is growing rapidly and starting to attract the attention of many mainstream investors.

This article takes you through some key points and information on impact investing, helping you understand this new and exciting way of investing.

So, what is impact investing?

Impact investing directs capital to enterprises that generate social or environmental benefits alongside financial return. At its core, it aims to bring the usually disparate worlds of driving profits and driving social impact – which have traditionally been treated as entirely different activities – together. Investing in commercial models that actively drive *and* measure social change while delivering financial return to investors is not only possible but represents a critical strategy to increase and maximise the amount of capital dedicated to impact.

Internationally impact investing is gaining popularity fast and some large investment managers are leading the charge. Al Gore's documentary, An Inconvenient Truth, led the way for the establishment of Generation Investment Management with Goldman Sachs, and together these two entities now manage $18.5 billion of capital assets mainly focussed on equities. Blackrock, the world's largest investment firm, is also an avid and vocal advocate of impacting investing as seen in CEO Larry Flink's annual letter in which he stated, "To prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society."

Recent developments on the home front

The impact investing sector in South Africa is relatively new but is gaining traction. In the last year alone, hil society has been established; the Public Investment Corporation has expressed interest in putting some of its assets towards impact (pension fund activity has often been a “game changer” around the world in terms of increasing impact capital); and President Ramaphosa’s recent Investment Conference featured an entire day focused on how impact investing can help drive inclusive growth in the country.

There is a growing number of players in the space – including fund managers, academics and advisors – all of whom have a role to play in building a strong impact investing ecosystem in the country.

With 20 years of experience in strategic social investing, Tshikululu Social Investments has recently expanded its focus into impact investing by developing and consulting on approaches that seek both social and financial return. As a strategic social investment consultancy, the company develops impact strategies, manages social impact programmes and provides continuous monitoring and evaluation for many of South Africa’s blue-chip corporates.

Our local regulatory environment needs to change

For the impact investing industry to truly thrive in South Africa, the regulatory environment must be conducive as well. Tshikululu Social Investments interacts with both social investors and social enterprises on a regular basis. “What we find for both groups – those with funding they want to deploy to drive social change and those who seek funding to make that change happen – is not an empowering environment, but a constrained one. We’ve recently completed an in-depth analysis, and it’s clear that there is a lack of appropriate legal frameworks for both social enterprises and impact investors,” says Tshikululu’s CEO, Tracey Henry

For impact investors, there are numerous vehicles that might be utilised, including Special Purpose Vehicles, Small Business Funding Entities (SBFE), Venture Capital Companies, Public Benefit Organisation (PBO) Trusts and non-profit companies to name a few. Each of these has distinct advantages and disadvantages, but none of them are ideal. Whether it is restrictions in terms of what type of investing can be undertaken, ineffective tax incentives or a lack of flexibility in terms of structure and duration, all these investment vehicles leave an innovative impact investor wanting more. For example, a SBFE is tax exempt, but not tax-deductible, which reduces interest in the vehicle. (Over the past four years, Tshikululu is only aware of one that has been established nationwide.)

For social enterprises looking to employ commercial (and sometimes untested) business models to solve entrenched social challenges, the options are even more limited. If an enterprise is registered as a non-profit company, it may be able to access grant funding but will struggle to secure other types of investment (especially if it also has PBO status from SARS). If it chooses to go the for-profit route, it may attract debt or equity investment, but almost all foundations and trusts will be unwilling (or unable) to provide financial support. In response, we see a growing number of organisations that are establishing both a for-profit *and* non-profit entity to attract different types of capital to support their vision. Such "hybrid" arrangements can take a variety of forms, such as the non-profit owning shares in the for-profit or one entity owning certain intellectual property which is then licensed to the other entity to implement. While there is nothing untoward about this approach, it adds bureaucratic and operational complexity – not the least of which is ensuring full compliance with multiple regulations and regulators – that distracts from delivering real social and financial value.

The road ahead

The private sector needs to work with leading foundations to support the creation of an impact investing strategy that can be adopted nationally and would include impact measurement, management, transparency and reporting principles. This is the purpose of The Impact Investing National Advisory Board which has been set up to facilitate, support and build the impact investing ecosystem by bringing together public, private and civil society organisations.

"It is essential that we create the smoothest runway possible for impact investors and social enterprises alike. At Tshikululu, we will continue to explore the regulatory space in the coming months and years in the hopes that we can contribute to setting the ecosystem up for success – and real, meaningful impact," says Henry.

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