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Policy approches to scale impact investment in Asia-Pacific

Donor and philanthropic funds add up to billions of dollars. However, the cost of solving the world's most critical problems runs into the trillions - including an estimated $2.5 trillion annual funding gap needed to achieve the Sustainable Development Goals (SDGs).[1] Private capital is urgently needed to fill this gap.Innovative finance solutions to mobilize private capital in new and more efficient ways towards development objectives have been pursued. One such solution is impact investing. Impact investments are investments made into companies, organizations, and funds with the intention to generate social and environmental impact alongside a financial return.[2]

The Addis Ababa Action Agenda contains a commitment to promote social innovation, of which impact investment is a key pillar.[3] However, it is recognized that to truly harness its potential, governments will have to actively work to facilitate the development of investible social enterprises defined as an organization committed to explicitly including social and/or environmental returns as part of its core business while seeking profit or return on investment, the creation of an enabling impact investment climate, and engage the mainstream private sector.[4]

The emerging impact investment movement in the region

The Asia-Pacific region has been at the forefront of this trend and the United Kingdom Department for International Development's (DFID) Survey of Impact Investment Market 2014 ranked Sub-Saharan Africa and South Asia as the largest markets for impact investment activity.[5] The Global Impact Investment Network (GIIN) published a survey of 158 impact investors from across the world in 2016. The report confirmed DFID's survey results by highlighting South Asia as well as East and South East Asia as key markets for impact investment.[6]

While data on impact investment is limited, GIIN has released a regional report on the impact investment landscape in South Asia, fowusing on six South Asian economies which estimated $9 billion of impact capital deployed between 2004 and 2014 in the six countries.[7] To date, the level of impact investing remains relatively small. There are several issues hindering the growth of impact investing, one of which is the lack of investment-ready enterprises in the region.

"Impact-driven" small and medium sized enterprises could be the backbone of an economy for sustainable development

Small and medium-sized enterprises (SMEs) are a source of employment, competition, economic dynamism and innovation across the world, and are particularly significant in Asia and the Pacific where the latest data indicates that SMEs comprise 96 per cent of all enterprises, employed 62 per cent of the national labour force and contributed 42 per cent of Gross Domestic Product (GDP).[8] SME's could potentially be a valuable source of innovation in the pursuit of the SDGs if the right incentives are provided to become more "impact-driven SMEs" or social enterprises.

Governments in the region have been at the forefront of experimenting with policy to support the growth of social enterprise markets. In North-East Asia, the Republic of Korea announced its Social Enterprise Promotion Act in 2007. The Act provides social entrepreneurs with management consultation and access to professional services, technical assistance and even provides subsidized rentals and reduced taxes. The metropolitan government of Seoul also opened a Social Economy Support Centre that acts as an incubator for social enterprises. This initiative, in tandem with other strategies, has resulted in a 353 per cent growth in the number of social enterprises in Seoul between 2012 and 2015.[9]

In South-East Asia, Malaysia recently produced a Social Enterprise Blueprint 2015–2018 to develop a social enterprise ecosystem which outlined a variety of policy measures, including building human capital by including social entrepreneurship in national education systems. Thailand has also actively focused on developing its social enterprise sector. The government established the Thai Social Enterprise Office in 2010 and followed it up with the recent Social Enterprise Promotion Act which facilitates tax relief for businesses establishing social enterprises as well as tax incentives for impact investments. Viet Nam's Enterprise Law was revised in 2014 to provide a legal definition of social enterprise and the government committed to encourage, support and promote the development of social enterprises through measures such as facilitating the raising of capital and the formation of public-private partnerships. The Philippines and Indonesia are also in the process of establishing policies to promote social enterprise in their economies.

In South-Asia, the governments of India, Pakistan and Bangladesh have taken steps to create an innovation ecosystem to support social enterprises. India's entrepreneurship policy framework[10] recognizes the emergence of social enterprise as a model for addressing social and environmental challenges through economic business models and has a focus on social entrepreneurship education through courses delivered by universities and academic institutions. A key objective of the government of Pakistan's Vision 2025 Plan is to promote innovation and enterprise. To support this objective, the government is establishing a Centre for Social Entrepreneurship to function as an incubator for social enterprises. Bangladesh, viewed by many as the birthplace of social enterprise, recently held a policy dialogue – Social Enterprise: Policy and Practice – that resulted in a report to the government on high level policy steps that could be adopted.

The policy mixes highlighted in the examples above include subsidies and tax incentives to encourage more social forms of enterprise, the provision of business support services and physical infrastructure to development high potential social enterprises, and a focus on social enterprise education to develop the next generation of more socially-minded entrepreneurs. Alongside the objective of developing more social forms of enterprise, the ambition of these policies is also that they will provide a pipeline of investible opportunities for impact investors.

Creating an enabling environment for impact investing

Securing access to finance and creating an economically viable SME is a challenge, and one that only gets accentuated in the case of social enterprises seeking to simultaneously pursue economic, social and/or environmental impact given that traditional investment decisions are made solely on commercial and economic criteria. Therefore, creating an enabling environment for impact investment is critical. However, before implementing policies to create an enabling impact investment climate, the foundations for an effective investment regime must be in place. Fundamental policy objectives such as efficient processes for starting a business, resolving insolvency, strengthening protection for minority investors and contract enforcement must be first order priorities.

From this foundation establishing seed funds, innovative financing mechanisms and providing incentives to investors to consider social and environmental dimensions in investment decisions are potential policy avenues to explore. As examples, the Australian Government commissioned the Social Enterprise Development and Investment Fund to leverage private sector investment for social enterprises. The Seoul Social Impact Bond will provide child welfare services over three years to a total of $9.4 million. The services will work with children and young people in group homes to improve their social outcomes and build capacity for long-term independence and wellbeing. In Thailand, the government incentivizes impact investment through tax reliefs. The Australian government's Social Enterprise Development and Investment Fund aim to leverage private sector investment is an important objective as diverting private capital towards development challenges will be critical to mainstream the scale of delivery required to meet the ambitions of the 2030 Agenda.

Moving impact investment from the margins to the mainstream

To move impact investment from the margins to the mainstream, it must be delivered at large scale. Corporations are equipped to deliver innovation at scale. The opportunity in Asia is significant given that 40 per cent of the Forbes Global 500 companies are headquartered in Asia.[11] However, in order to create social and environmental value to complement their economic imperative, corporations need to move beyond the concept of corporate social responsibility (CSR) and its focus on “public relations” or “community service” to redefine their objective as creating “shared value”.[12] Creating shared value is the practice of creating economic value whilst explicitly incorporating social and environmental outcomes in the decision making process. Shared value is not CSR, rather it is defining value across the three dimensions of sustainable development as part of the core business strategy and reporting process. Governments have a role to play in incentivizing mainstream reporting of societal and environmental impacts alongside economic returns.

Specific polices aiming to unlock shared value are rare, however India has experimented with policy applications on this agenda. In 2011, India released the National Voluntary Guidelines to encourage the adoption of responsible business practices and to mainstream disclosure and reporting on environmental, social and governance metrics in India.[13] The National Voluntary Guidelines were launched by the Ministry of Corporate Affairs and provide businesses with a framework to enable them to move towards responsible operational decision making and adopt a “triple-bottom-line” approach (economic, social and environmental).

In a move to incentivize shared-value creation, India is the first country to enshrine corporate giving into law in 2014. The law mandates companies with a certain turnover and profitability to spend 2 per cent of their net profit on activities across several categories, which include hunger and poverty, education, health, gender equality and women’s empowerment, skills training, environment and social enterprise.[14] In addition, companies that have to comply with this law are required to report on their activities. While this initiative could be seen as an extension of CSR, the policy intent is to raise much needed finance for social and environmental challenges and to move conversations about CSR from the fringes to the boardroom as companies are made to think seriously about their legal obligation.[15] Shared value could reshape capitalism by making the relationship between firms, society and the environment more explicit, and government has a key role to play in incentivizing this reshaping.[16]

Incentivizing more impact-driven corporations could provide a more secure investment – when compared to an early-stage investment in a social enterprise – to attract mainstream capital from sources such as private equity funds, pension funds, insurance firms and sovereign wealth funds amongst others. However, incentives such as appropriate tax relief will be required to attract large scale investments in corporations which create public value but may generate below-market returns.

Creating a market for impact investment

To ensure the long term viability of impact investment, it will be critical for governments to create markets for this type of investment. In this regard, potential policy priorities could include embedding impact investment principles in government procurement, trade agreements and stock exchanges.

Government procurement can represent large investment flows in economies and opening up procurement to impact-driven SMEs and social enterprises would provide a valuable source of capital for their growth. Explicitly applying social and environmental criteria in the public procurement decision-making process could also incentivize more established businesses to engrain social and environmental purpose in their core business models. As examples, the metropolitan government of Seoul enacted an ordinance to procure goods and services from social enterprises ($57 million in 2015). Additionally, the World Bank’s new procurement framework for infrastructure projects – often the baseline for national procurement policies in developing nations – also allows for the inclusion of social and environmental impact criteria in the selection of vendors. In an effort to address climate change, the Government of Singapore recently announced plans to procure only electrical products that have been certified with high energy efficiency. In addition, the Government will only procure printing paper that carries the Singapore Green Label, which indicates that the supplier practices sustainable forestry management.[17] The intent is that by having a sustainable, green procurement policy, private sector suppliers will consider sustainability in their business models so that they can retain market share.

In recent years, the multilateral trading system has witnessed an amplified volume of trade in technology with significant environmental implications. In light of a changing climate and increased environmental degradation, trade policies for sustainable development must support the trading of technologies from conventional to environmentally sound technologies through a range of regulatory means and incentives. Environmental regulations have encouraged industry to reduce its climate footprint, signaling growth in the trade of “green” technologies. This has elevated global trade in environmental goods to $1 trillion annually. With international measures like the Environmental Goods Agreement (EGA), global trade in environmental goods is projected to further grow to $3 billion by 2020. An increased focus on trade policies that promote the transfer, dissemination and diffusion of innovations for sustainable development will be an important aspect of future trade agreements and provide growth opportunities for impact-driven enterprises.

It may be that the ability to list on a “social stock exchange” would make it easier for such firms to conduct an initial public offering (IPO) and attract impact investors who are motivated to protect and advance the social missions of the firms in which they invest. Social stock exchanges have begun to emerge. The oldest and most established is the Impact Investment Exchange (IIX) in Asia, which was established in 2005. The IIX was developed to be Asia’s first private and public platform for social enterprises to raise capital.[18]

Governments in Asia and the Pacific have demonstrated leadership and innovation but more analysis and evidence is required to establish best practices

Governments in the region have demonstrated global leadership through the implementation of innovative and experimental policies to build ecosystems for social enterprises, create of enabling impact investment climates, and incentivize the mainstream private sector to adopt impact investment principles.

This policy brief has highlighted the breadth and diversity of policy approaches that governments in the region have implemented to harness the potential of impact investment. It is important to recognize that the concept of impact investment is in its relative infancy. The evaluation of the impact of these initiatives should be a policy priority for the region alongside continued and well-evaluated innovative policy experimentation to establish what works and equally importantly, what does not. Through these activities, best practice frameworks can be developed to unlock the potential of impact investment for the SDGs.

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[3] See United Nations (2015). Addis Ababa Action Agenda of the Third International Conference on Financing for Development, Paragraph 116, Addis Ababa Action Agenda.

[4] Shelagh Whitley, Emily Darko and Grace Howells, *Impact Investing and Beyond: Mapping Support to Social Enterprises in Emerging Markets* (London, Overseas Development Institute, 2014).

[5] DFID, *Survey of the Impact Investment Markets 2014: Challenges and Opportunities in Sub-Saharan Africa and South Asia* (London, 2015).

[6] See GIIN, *Annual Impact Investor Survey* (New York, 2016), figure 14, pp.14. Available from https://thegiin.org/assets/2016%20GIIN%20Annual%20Impact%20Investor%20Survey_Web.pdf

[7] See GIIN, *The Landscape for Impact Investing in South Asia* (New York, 2016) figures 1A and 1B, pp.1. Available from https://thegiin.org/knowledge/publication/the-landscape-for-impact-investing-in-south-asia.

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The ESCAP Policy Briefs aim at generating a forward-looking discussion among policymakers, researchers and other stakeholders to help forge political will and build a regional consensus on needed policy actions and pressing reforms. Policy Briefs are issued without formal editing. The content of this issue was prepared by Susan F. Stone and Jonathan Wong. This policy brief benefited from comments by Naylin Oo. For further information on this issue, please contact Hamza Ali Malik, Officer-in-Charge, Macroeconomic Policy and Financing for Development Division, ESCAP (escap-mpdd@un.org).

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