February 27, 2018

BW BUSINESSWORLD

In Impact Investment, You Think Of 3 Dimensions – Risk, Return And Impact: Sir Ronald Cohen, Chairman, GSG

In an exclusive interview with BW Businessworld, Sir Ronald Cohen, Chairman of GSG (Global Steering Group) and Amit Bhatia, CEO of GSG discuss impact investing and its benefits, along with the 2 funds created by GSG

26 February, 2018
by **Anurit Kanti**

Impact Investing is a funding approach which involves investors pooling in a corpus that is further disbursed to implementing partners, namely social enterprises to support development projects. Further funds are pumped in only when the partners meet certain pre-determined outcomes with measurable impact. The investors, in turn, gain financial returns from their investment as profitability is achieved with the success factors being met. In other words, Impact Investing is different from traditional CSR models where measurable impact and returns on investment are not intrinsically linked to sustained fund flow and hence and success of the project. In an exclusive interview with BW Businessworld, Sir Ronald Cohen, Chairman of GSG (Global Steering Group) and Amit Bhatia, CEO of GSG discuss impact investing and its benefits, along with the 2 funds created by GSG. Edited excerpts: **India Education Outcomes Fund and India Impact Fund of Funds**

So how does impact investment facilitate measurable and accountable change?

Sir Ronald: it's based on measurement so the big advantage of its that you cannot call yourself an impact investor or an impact entrepreneur if you don't measure the impact that you create and securities like the Social Impact Bond actually tie a measurable impact to a financial return which is a big innovation that impact investment has brought.

How is the impact investing different from CSR and funding approaches?

Sir Ronald: So, CSR involves an intention to do something, it doesn't involve measurement of it. Very often it's just donation of some kind. Impact investment has to do something with getting you money back with a return which is linked in some way to impact that you have created and it differs from the normal investment. In that, normal investment, you think about risk and returns - two dimensions when you make a decision. In Impact investment, you think of 3 dimensions – in 3D - risk, return and impact.

About the two funds- so how do these two funds- India Education Outcomes Fund and India Impact Fund of Funds serve an opportunity for investors and corporates in India to participate in bringing about a measurable social development in a sustainable and profitable manner.

Amit Bhatia: This year GSG is bringing its annual summit to India which travels country by country every year and to make sure we can contribute something to India's Impact Investment ecosystem growth, we visualize these two funds to be catalytic in nature, filling two big gaps in the Indian impact investment ecosystem. One big gap in the ecosystem was almost all our impact investing is purely venture capital approach so the $1.1 billion that comes in, all comes in through impact funds or they are invested in for-profit social enterprise which have to grow, exit, list. The outcome fund for the first time allows impact investment in India to be purely and solely focus on the outcomes and the return to the investors is linked to the outcomes. So the exit for the investors is not linked to selling that investment, it is linked to getting an exit through another philanthropic fund which we setup back to back with this impact fund and that philanthropic fund is called the outcome fund. So instead of growing the company and listing it, you deliver the measured outcome. So, in education it could be let's retain instead of 50%, 80% of girls in secondary schools and let's make sure instead of 10% of people who get employed after grade 12, 35% get employed, let's make sure in early childhood intervention instead of young children starting with the basic motor skill literacy or numerical skills you are not 2 years behind private schools that they start without any gap viz-a Viz. So, we create outcomes and if the end enterprise delivers the outcome, the impact investor makes money. The second important thing, the gap that this impact fund fills is that for the first-time non-profits come into the system. In the venture capital approach its only for-profit social enterprises but in the outcome fund approach the end entity that delivers the outcome can either be not-for-profit or for-profit because the exit comes on the delivery of the outcome.

So, this the first fund I let Sir Ronald add something about outcome fund then we'll explain India impact fund of funds.

Sir Ronald Cohen - I think that the outcomes fund enables us, enables the world to turn a social challenge, an educational challenge and turn it into an investment opportunity

So, can you give more details on the mechanism of the funds and its intended corpus and the details about its operations?

Amit Bhatia: Let me answer the earlier question about the second fund we didn't give enough information.

The second big gap in the impact investment ecosystem was that bulk of this existing investment coming into India is all equity, there is very little debt and amongst the debt that exists in the market, most of it is short-term and most it is against collaterals. We thought that if we have to truly galvanize India impact investing ecosystem, we need to make sure there is a long-term affordable debt in all stages, from venture debt, to growth debt, that can further catalyze the economy. So, both these funds are One Billion USD in size, both of these funds right now are visualized to run up till 2030 and both these funds are filling these essential gaps and are first in India. The India Education Outcomes fund is the first outcome fund not just in India possibly in the world. There is another big effort going on in Africa and similarly, the India Impact Fund of funds is the first dedicated impact fund for India.

So, any other detail about the mechanisms would you like to add or intended corpus and details about its operations.

Sir Ronald Cohen: Paying for outcomes was not existent before. So, we are designing a Government that is appropriate for this new vehicle. It will have an advisory board and it will have a team managing it. The purpose is to set metrics at the level which leads the investors and the organizations they support to achieve the outcomes to innovate and to be entrepreneurial and to scale in tackling the social issues. So, the aim is to enable a system, in terms of the education, say in terms of the attainment level. So, we are putting together an organization called Social Finance, which exists today in the UK, it invented the social impact bond 7 years ago; It exists in the US; It exists in Israel. We are creating a Social Finance India to manage this outcomes fund.

So, who are the potential stakeholder or beneficiaries of these two funds?

Sir Ronald Cohen: The beneficiaries are very clearly the schools, the pupils, the teachers, the parents. The stakeholders will be foundations - leading foundations in India and across the world possibly, official aid organizations which believe in outcomes based aid and we hope CSR money which would flow into this vehicle and we will enable it to scale and after education we can see the replication of outcome funds for health and for other big social issues.

What is the expected outcome on the ground of initiation of these funds and how can this impact be scaled up further?

Amit Bhatia: So, in the education outcomes fund, last year in November, the Government benchmarked for the first-time learning outcomes in Grade 3, 5 and 8 we'll now will know, just like the Niti Aayog released the health report, they will release education report; we will know the best states and the worst states. We are going to pick up some states in phase 1; so there will be many phases between now and 2030; and the impact of the outcomes are got to be, that whatever regions we pick up the learning outcomes there or retention rates there match the best states so you go to cover the learning gap and we have to make sure that that shows through independent audits like the kind of assessments the government does. So, on the education side because of this measurement, it'll be possible. So next time you read an ASER report we should not be reading grade 8 kid cannot read a grade 3 book or grade 5 kid cannot do grade 2 maths. So in the regions we pick up and put the service providers, in finite time, there will be some intervention of 2 years, 3 years, 4 years; those learning gaps and retention gaps have to be addressed. In the India Impact fund of funds all the sectors are included so the first fund is of education and the second will include all funds of all sectors- healthcare, water, sanitation, agriculture, financial inclusion. Again the end beneficiary is the poor, as these are the bottom of the pyramid focus funds and we are going to measure - are their earnings increasing, if it's a skills exercise - Did they get a job, on what salary did they get the job, how long did they stay in the first job. So those will be the kind of metrics, so that the return is based on this. So, when you link the return, in the end, the difference in this thing is because the incentive of the asset managers in the middle, we are creating funds of funds and an outcome fund, we will not be giving money directly to a social enterprise. In the middle for the India impact funds of funds will be many debt asset managers and in front of the outcome fund there will be what we call DIB (Development Impact Bond) funds, other impact funds who are going to intermediate. For these intermediaries, for the first time their incentive and income is linked to the impact and that impact will be audited this didn't exist in this country earlier. The moment you change how you are incentivized, the moment you change what you are evaluated for, our behaviors change and what we are doing is putting the poor back, the student, the patient back- at the heart of the issues which we try to solve.

And this can be scaled up further…

Amit Bhatia: Absolutely, once we figure out the trick, we know how to get the learning outcome or we know how to get the primary care to this or a person in an ambulance to the hospital in so many hours instead of days; Once you get the maths then you bench mark right just Niti Aayog is doing. Once these benchmarks exist, human race is built in terms of race to the top. It's a challenge right now – states are racing to the top for education. So, human beings are competitive so I think they need to know where they stand in the hierarchy.

Sir Ronald Cohen: But scaling you built on a system which is capable of scaling quite easily; because it is based on attracting investment capital to achieve measurable outcomes in a transparent and accountable way. That's highly scalable, because investors are prepared to invest if you deliver these four different characteristics along the way. India will be the first country in the world to establish these funds.

How can impact investment be catalyzed globally to deliver private capital for social and environmental good?

Sir Ronald Cohen: Impact investment, which is based around optimizing risk, return and impact in a transparent and accountable way, is the path to impact economies ; where the decisions made by the investors, business are based on three dimensions instead of two- risk, return and impact. We can already see an evolution in thinking across the world, which has led to regulation changes and new legislations to encourage investors and businesses to take the impact of the actions into account. The governments by themselves cannot provide all the possible improvements. We need the whole system to provide that, so it is the transformation of the capitalist system, to drive capital flows, to achieve impact as well as profits.

What are the leading examples of Impact investment success in the world?

Sir Ronald: The Social Impact Bond was created about seven years ago. It is the most perfect expression of the risk-free term of impact, in appropriate way. Now there are 108 social impact bonds across the world, including India. They cover 24 countries, 14 different social issues and they are almost same number in the pipeline. So, we are beginning to see the Social Impact bonds and we are thinking on how to scale it. We have Impact venture funds in different places – in the UK and US- they have been very successful. The Impact Venture funds are the funds that do venture but with the aim of improving the lives, the environment at the same time. We have Impact real estate funds, which have done well financially. Both of them are doing well. They are delivering market rates of return and measurable impacts. There are infrastructure funds that are beginning to think in terms of impact. So, it ties together with the effort to get big companies to push ESG- environmental, social and governance considerations in their decision making. But it adds to this intention – measurement - Measurable objectives, measurement of the performances in achieving them. So there is plenty of evidence across the world that this works.

Amit Bhatia: You got big list of funds but so that your readers can identify with the companies- Think of Tesla – It has impact enterprise - $7 billion in size. Tom shoes – It has an impact enterprise – where for every pair of shoe bought, the company gives a pair of shoes to poor- that company has scaled to 200-300 million in size. Think of Revolution Foods in US – They are into healthy food for children- It has scaled up to several hundred million. In India, it is old - Amul is $5 billion in revenue. Amul is a co-operative which creates profit- is 75 years old in India and is an impact enterprise. Grameen Bank is an impact enterprise. These are the oldest models in India. In 2016 there were 3 IPOs of impact enterprises in India – Narayan Health, Ujjivan and

Equitas. They were oversubscribed, these IPOs 14-40 times. That data would be with you. Last year AU Financials became a bank, as coming out of micro- finance company, a small bank as reserve bank - that's an impact. So, we have so many examples in India, Bangladesh, UK, US these are all impact enterprises which directly touch the poor.

So, can one model of impact investing be replicated across multiple regions or is there a necessity to localize or adapt it?

Sir Ronald Cohen: It looks like it needs to be adapted but then you can use the same basic model in the way that venture capital was a model that could be replicated and adjusted for different countries. So, the idea of measuring the impact is a universal idea. The idea of attracting investment capital to address financial challenges, while delivering attractive rate of return, is a universal idea. Country by country you have different ecosystem, you have different stakeholders and the trick is to adapt it so that you begin to get capital to flow, that harnesses the entrepreneurship and innovation in an appropriate way for each country and that looks like it is different for country by country.

What are some of the challenges of the impact investing?

Sir Ronald Cohen: So, one of the challenges of impact investing is that you are dealing with human beings and you have to set the objectives and the metrics in the most appropriate way so that you don't get unintended consequences. There is expertise in doing that and we are developing the expertise as we begin to see the 108 social impact bonds achieve results which are better or a bit worse and we can begin to gauge what we expect. The second is that it requires a change of mindset. The change of mindset is not just for the investors who are putting up the money, often the entrepreneurs who begin to think in terms of using either a not-for- profit model or profit with purpose model in order to achieve a particular positive impact. But it also involves a change of mindset on the part of government. Government has to begin to think in terms of outcomes not inputs, of measurements not just getting everything for the lowest possible price and that's a big change of culture and governments need to be very supportive partners in this effort. It is not an effort today which is asking governments for money even, this outcomes fund, this billion dollars; We are not saying to the government that it has to put the money into it, we welcome it if government wants to give the money but we are saying we will do this, just support the way we do it. So big challenge for impact investment is for government to begin to absorb its mechanism, its intentionality, its measurement.

Amit Bhatia: And also Ronald, perhaps even the asset owners, the rate adoption, in terms of having allocation, would you consider that an opportunity or a challenge?

Sir Ronald Cohen: I think the change in the mindsets of investors which would bring them to allocate their portfolios to impact creation is probably the most important challenge today. We see evidence of it taking place, you see the latter from Larry Fink CEO of Black Rock, from the company portfolio, $6.3 trillion worth of investment, saying that he expects CEOs to deliver positive impact socially and environmentally as well as financial return. That needs to translate into allocations from portfolios to impact investment, allocations from pension funds, from insurance companies and from mutual funds from high network individuals and in a way that is a process which has already started to become visible so the Ford Foundation made a billion dollar allocation from its endowment to investing in impact. Not from its grant program, but from its 14 billion dollar endowment. 17 or 18 Dutch pension funds have come together to connect their portfolio strategy to social development goals. So, we can see that it has started but it is probably the single most important constraint to them. We would like government to be supportive but if investors begin to make allocations, it will make it much more obvious to the government that this is something they have to do.

Amit Bhatia: It may not be the question you wanted to ask but your readers will primarily be Indian there is one thing which will be great if you can evaluate and consider in your story which is since ITITES we never had the opportunity to have next big Indian export to the world which create millions of jobs and S gets billions of dollars. The journey from first software company to a billion dollar in software exports took longer than the journey from the first dollar, which was in 1992 when first fund Aavishkar and Lok Capital was setup in 1992-93 to billion dollar to impact investment we got faster. I can separately show research which IDFC bank did - Social Enterprises create 8 times to 12 times more job for every million dollars of assets created because they have to reach the poor, they have to reach the villages, there is less automations, less mechanization, its more of services and they create more jobs. Like ITITES, Impact Investment offers India an opportunity, because we are the RnD base for the world, with 300 million poor, we exported the microfinance model ,to let's say East Africa who just put on a mobile phone and innovated on it. So India has an opportunity, (we building two large funds) to export to the world our know- how in the development sector or an impact sector and that has the potential to be the next ITITES like from India. The McKinsey report said that we'll grow from 1 billion in 2015 to 2020 to 2.5 to 3 billion investments annual and could grow to 5 to 8 billion annual investment by 2025. By creating these 2 funds we just probably expedited the targets. That is the big opportunity. So as your readers read this, they should now there is something out there which can be the next big thing for India.

Sir Ronald Cohen: And the 2 funds between them we dedicate the amount 1 and a half billion dollars of investments which would add to the 5 billion dollars according to the Mckenzie report so it is significant as it increases the supply to capital by 30%.

Also speaking of partnership and all, how does GSG use the power of collaboration and synergy to deliver impact investing goals?

Sir Ronald Cohen: So, at the level of GSG, it's all about collaboration with our National Advisory Boards, we have 17 of these around the world now. We are about to add a number to it. Krisztina is in charge of that effort. And we are creating a platform for the sharing of information and effort so that through the working groups that we have established, we can begin to pool in the knowledge and the experience and then accelerate the move to the tipping point 2020. That's our objective. By 2020, we want to get to a point where it is obvious to everyone that this is something which is now going to be big that there is acceleration in its growth. So, we have a great benefit from being global and an obvious benefit is that when you think in terms of G 20 countries or G7 countries which have influence all across the world and where we are working through our local National Advisory Boards in Canada, and in Argentina to help to shape discussion around the G20 meeting around inclusive economies to begin to bring the tools of impact investments to these countries on the road to creating impact economies. So, it's all about the collaborations, approximately more than 300 people sit on the National Advisory Boards.

Amit Bhatia: But even at the fund level it's been very collaborative. So, when you read this business plan which is lying in front of you, you will find for the India Education outcome fund, we work with the Mckenzie, we work with Central Square Foundation and we work with Nishith Desai and Associates to create the plan. When you look at the business plan for India impact fund of funds, we work PwC, we work with UNSIF (United Nations SDG Impact Finance) and again Nishith Desai and associates to create those and we are happy to let you know that Sir Ronald has secured some of the leading leaders on board. So the first two board members who have been announced recently in our consultation Rajiv Lal who is currently the CEO of IDFC Bank will be the Non- Executive chair of Social Finance India and Ashish Dhawan who is the CEO of the Central Square Foundation and founded Ashoka University - so he is a board member of Social Finance India. these are stellar people and you know what they did with Ashoka – It is a first class university in a few years. In 2016, Sir Ronald gave a talk at the university. So, these are kind of board members we are bringing together. So, these will have a national character. Both these funds have a very national character in the kind of people that are coming together to collaborate.

Sir Ronald Cohen: So, in a fundamental way, the Social Impact Bond brings service providers together to achieve an outcome. So, you might have people who are working on one aspect of education but they are not focusing on the outcome that they would probably needs 3 different organizations to work together in order to achieve it. So, you might have some focusing on more effective teaching, some focusing on more effective learning some working on parental influence ; unless they work together it is very difficult to achieve the outcome. So, the social impact bond enables funding to go to a number of organizations of the same kind to achieve the outcome.

One last question. What are some of the facets of the impact entrepreneurship?

Sir Ronald Cohen: So, what is the difference between impact entrepreneurship and normal entrepreneurship. The difference is that you are putting impact as a key measurable objective. Now this can trunk straight into the measurement of impact for an NGO and attracting investment capital that NGOs could never do before. Now they can attract investment capital or it can be entrepreneurs defining new business models that have impact at their core. The more impact you deliver, the more money you make. You can have the platform to help out the poor get out of debt. The more poor single mothers you help, the more money you make and I think the big innovation is going to be in both places theses efforts to achieve the measurable impact. Otherwise the process of entrepreneurship, the process of complete transformation for the particular sector; The agility that entrepreneurs bring, all of those processes are very similar to business entrepreneurship but instead of worrying like a venture capitalist about the risk and return with some vague intentions to do good, you are now worrying about the risk, return and impact at the same time

Amit Bhatia: So Anurit, like Sir Ronald said if you want to put it in bullet points for your readers then you should use the word 'intentionality' in memorandum, articles, vision statement of a company as it will be different, a beneficiary focus. the impact entrepreneurs can think regionally, thematically while really care farmers I'll do agri stuff, I really bring financial skills so I'll do financial inputs, I am a doctor like Dr. Reddy , I'll bring Narayan health, so they are focused on beneficiaries. The third is measurement that Sir Ronald said

Sir Ronald Cohen: So, I think the big innovation it to turn social and environmental challenge into investments and opportunities.