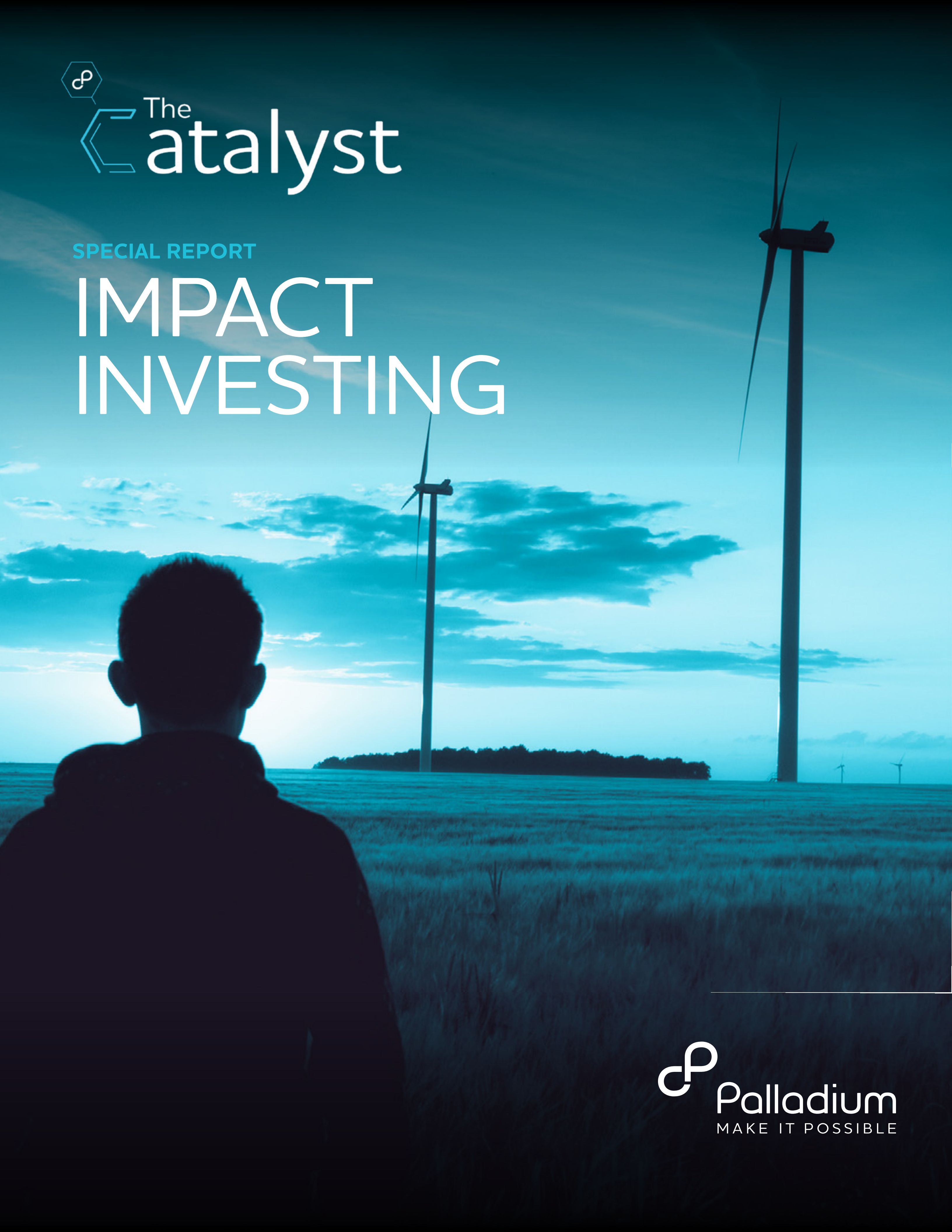
The Catalyst

SPECIAL REPORT

IMPACT INVESTING



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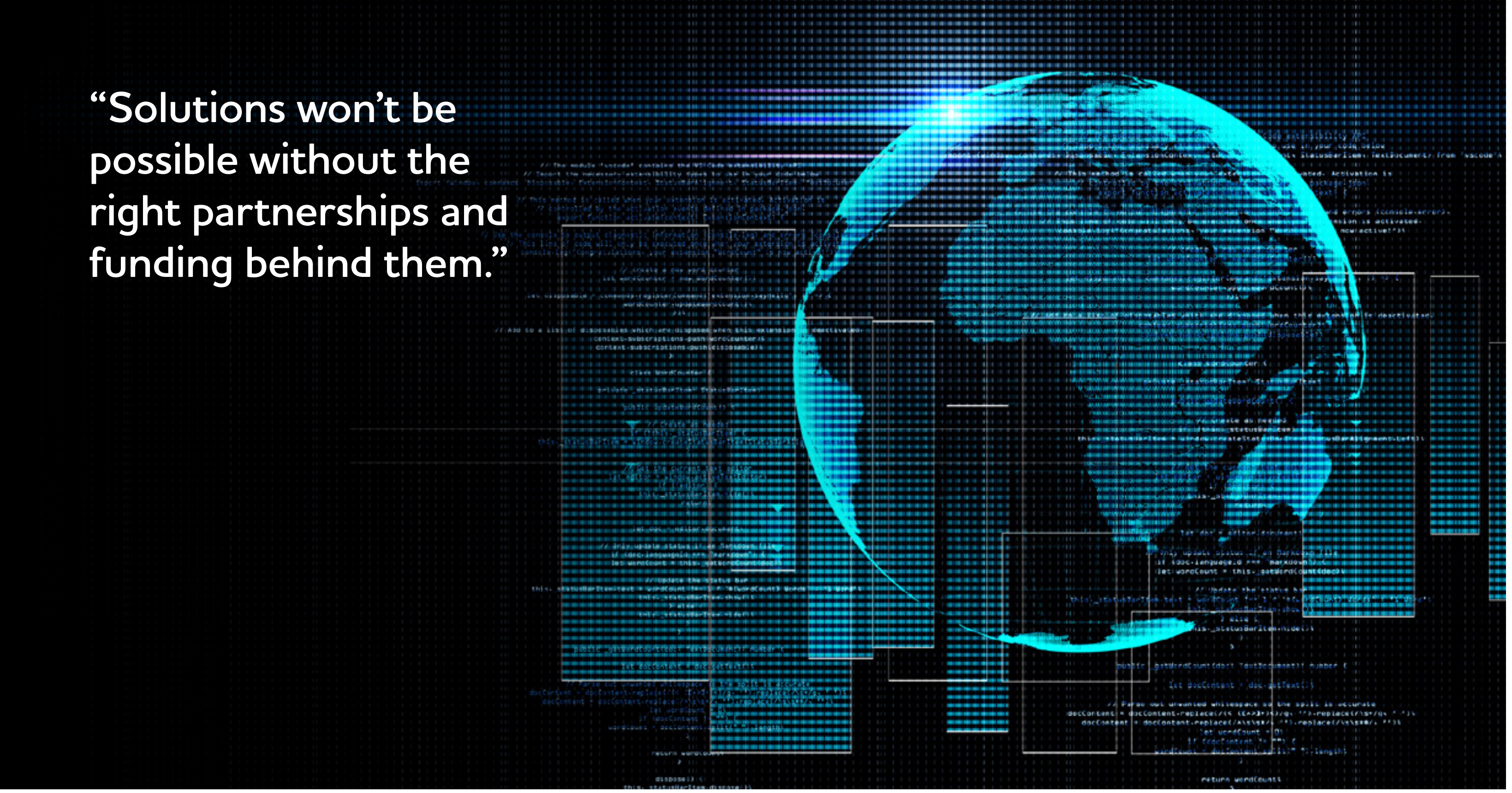

Letter from the Editorial Team

Even prior to the COVID-19 pandemic, there was a USD 2.5 trillion annual funding gap between our best intentions and success against the UN’s Sustainable Development Goals. Now, estimates suggest that the fallout from COVID-19 is expected to set the Global Goals back by over 30 years, amplifying the need to source additional funds. Impact investing is no longer a ‘nice to have’; it’s the way of the future for the investment industry. As we come up against larger global, and societal problems, the solutions won’t be possible without the right partnerships and funding behind them.

Impact investing offers an opportunity to build social impact directly into investments, and, as more organisations and governments recognise the growing link between financial markets and social change, the need increases for mechanisms and vehicles that allow investors to take action against social, environmental, or developmental challenges around the world.

Of course, the industry isn’t without its challenges. As many traditional investors shy away from ‘risky’ investments in assets like natural capital, others are struggling to measure the impact they’re creating.

Our team is at the forefront of the impact investing industry, exploring boundaries, assessing where there is room for growth, and creating opportunities to attract capital to address global challenges at scale. They’re committed to creating positive impact in both the smallest and biggest ways around the world. They do this by utilising creative means to fund projects that address and answer the difficult questions our society faces, shifting the narrative around how we value nature in the fight against climate change.

The articles in this edition of our quarterly Special Report are curated from those published by our thought leaders and reflect their perspectives on the impact investing industry from their unique experiences and points of view .

We hope you’ll find something in these pages that resonates with you, and if so, we welcome you to get in touch.

Best,

The Catalyst Editorial Team
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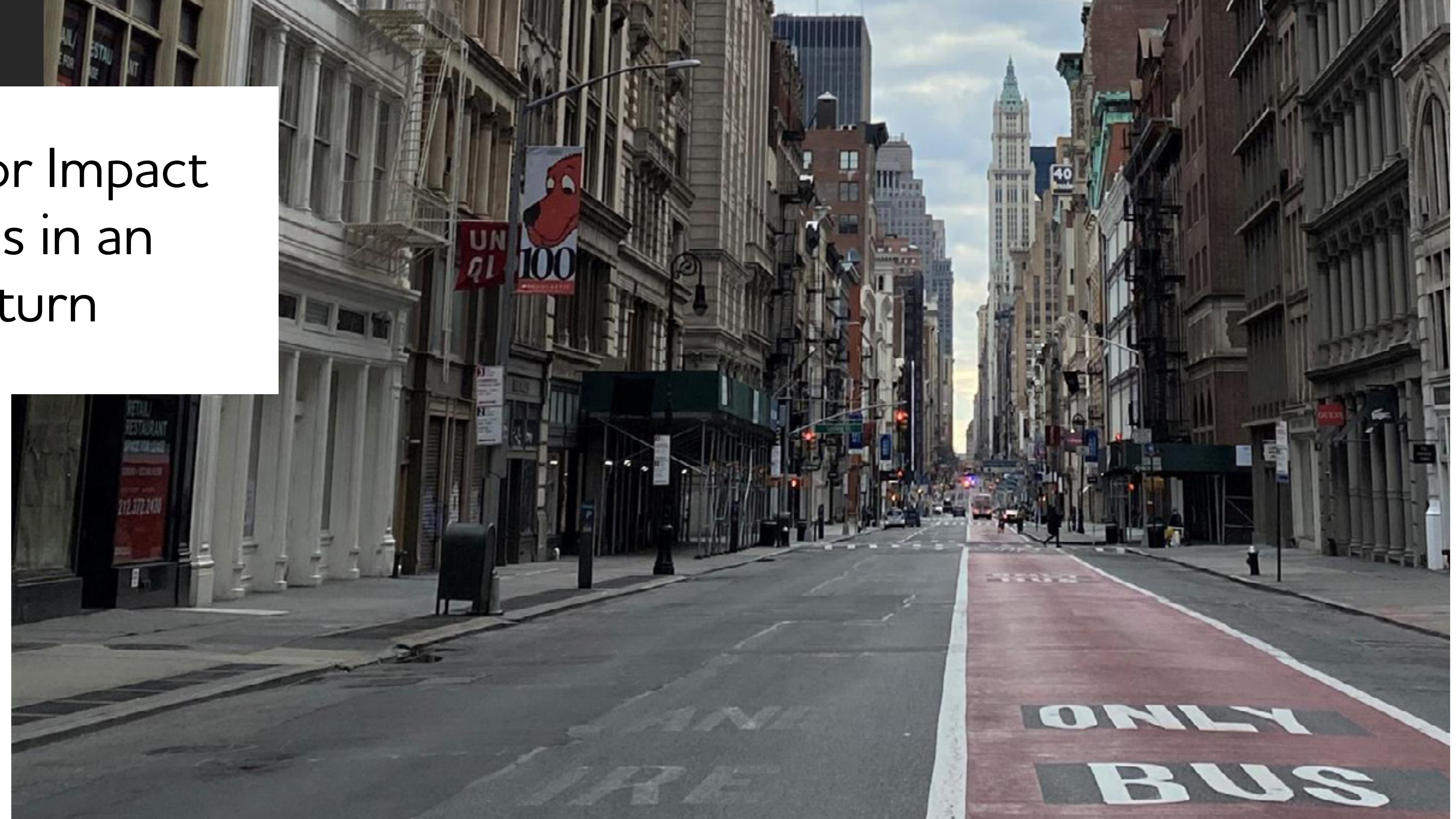
Capital Raising for Impact Investment Funds in an Economic Downturn

BY
Preeth Gowdar
Director, Palladium



ABOUT THE AUTHOR
Preeth leads a diverse range of client engagements across the areas of capital raising, transaction and fund structuring, and strategy development. He advises entrepreneurs, fund managers, non-profit organisations, and corporations with his focus sectors primarily spanning financial services, healthcare, and agribusiness in developing countries.

When developed countries experience a prolonged economic slow-down (such as the one toward which we are currently accelerating), it's long been felt that investments in emerging markets can offer reduced volatility and opportunities for growth. Emerging market businesses are often more resilient to macroeconomic shocks and downturns, while middle class populations, who are more economically tied to the swings of financial markets, tend to be more intensely affected than low-income communities.

Despite these dynamics, international impact investing is far from protected from the coming downturn. During the financial crisis of 2007-2009, struggles in the U.S. and European economies did have an effect on the impact investing sector, choking the flow of capital into impact investment funds. This was a time when the microfinance sector was proving that businesses that serve low-income segments could successfully absorb venture capital and private equity funding, and the widespread success of Microfinance Investment Vehicles resulted in a new generation of multi-sector impact investing funds.

But as these emerging fund managers were seeking to raise capital during the hangover period following the recession, many funds were slow to get off the ground. Raising capital at the Limited Partner level was difficult, especially for those moving beyond the Development Finance Institutions (DFIs) to target private investors.

> "As the sector has grown, it's become progressively interlinked with international capital markets, and now faces a heavier challenge from the next downturn."

After a temporary deceleration, the impact investing sector bounced back with exuberance, spawning a diversity of fund managers over the past 10 years. But as the sector has grown, it's become progressively interlinked with international capital markets, and now faces a heavier challenge from the next downturn.

Since 2010, fund managers have moved away from being anchored by DFIs. Impact investors are increasingly tied to allocations from institutional investors, family offices, and philanthropic endowments that, together, remove a degree of separation from between the sector and the macroeconomic environment. We will see the effect of the recession more profoundly challenge the impact investing sector in the coming months and even years.

Fund managers and General Partners who are currently seeking to launch funds need to quickly adapt to the changing investment environment. Tactics exist to navigate what will be a more competitive fundraising environment, where investors may reduce allocation sizes and risk tolerance across their portfolios. These reductions will likely happen with particular attention to illiquid strategies in emerging markets.

Needless to say, each fund manager's situation requires a custom review of their fundraising strategy, and the following considerations may help.

- **Recalibrate the fundraising target.** Consider resetting your fund raise goals at the outset; it is never prudent to announce targets that are unlikely to be met. Developing more realistic '1st close target' expectations going into a fundraise process may make for more realistic interactions that will earn you greater credibility. Investors will be more interested in committing to something that will have a greater likelihood of close.
- **Reprioritize investor marketing efforts.** Place a priority focus on DFIs and other public institutions that will arguably be less prone to tightening emerging market allocations. Double up on efforts to solicit commitments from existing investors.
- **Understand whether opportunities lie in refining investment strategy.** Depending on how long-term an outlook you're open to taking, modifying investment strategies can be a useful tool to better align with changing investor preferences. Though each market comes with a great deal of nuance and it is difficult to generalize, bolstering allocation to "unsexy" sectors may be attractive. For example, consider increasing the focus on operating businesses serving core sectors and less on the technology models surrounding them. Investors will be seeking to trade scalability for stability. High growth or high leverage propositions will become more difficult to sell.

  Additionally, consider foraying into or bolstering the use of asset classes that may be more compatible with the future environment, risk averse.

  For example, consider employing debt, which can take advantage of a lower interest rate environment, or utilise instruments that have a running yield and, ideally, are also self-liquidating.
- **Introduce risk-mitigation through the capital structure.** Where possible, build in first-loss capital through a layered structure or build in partial guarantees.
- **Ensure the investor distribution is expanded from the outset.** If a placement agent has a network that aligns well with your strategy, they can greatly increase the efficiency with which you connect with relevant prospects. They can significantly expand the diversity and number of investors you engage with and will, most certainly decrease the time it will take to reach those investors. In a fundraising environment with heightened competition, an appropriate partner can be key to success.

There is a great deal of uncertainty in today's markets, but there is certainty in knowing that strong preparedness will be worth the investment.

> "There is certainty in knowing that strong preparedness will be worth the investment."

Making Impact Measurement More Inclusive for All

BY
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★ FEATURING
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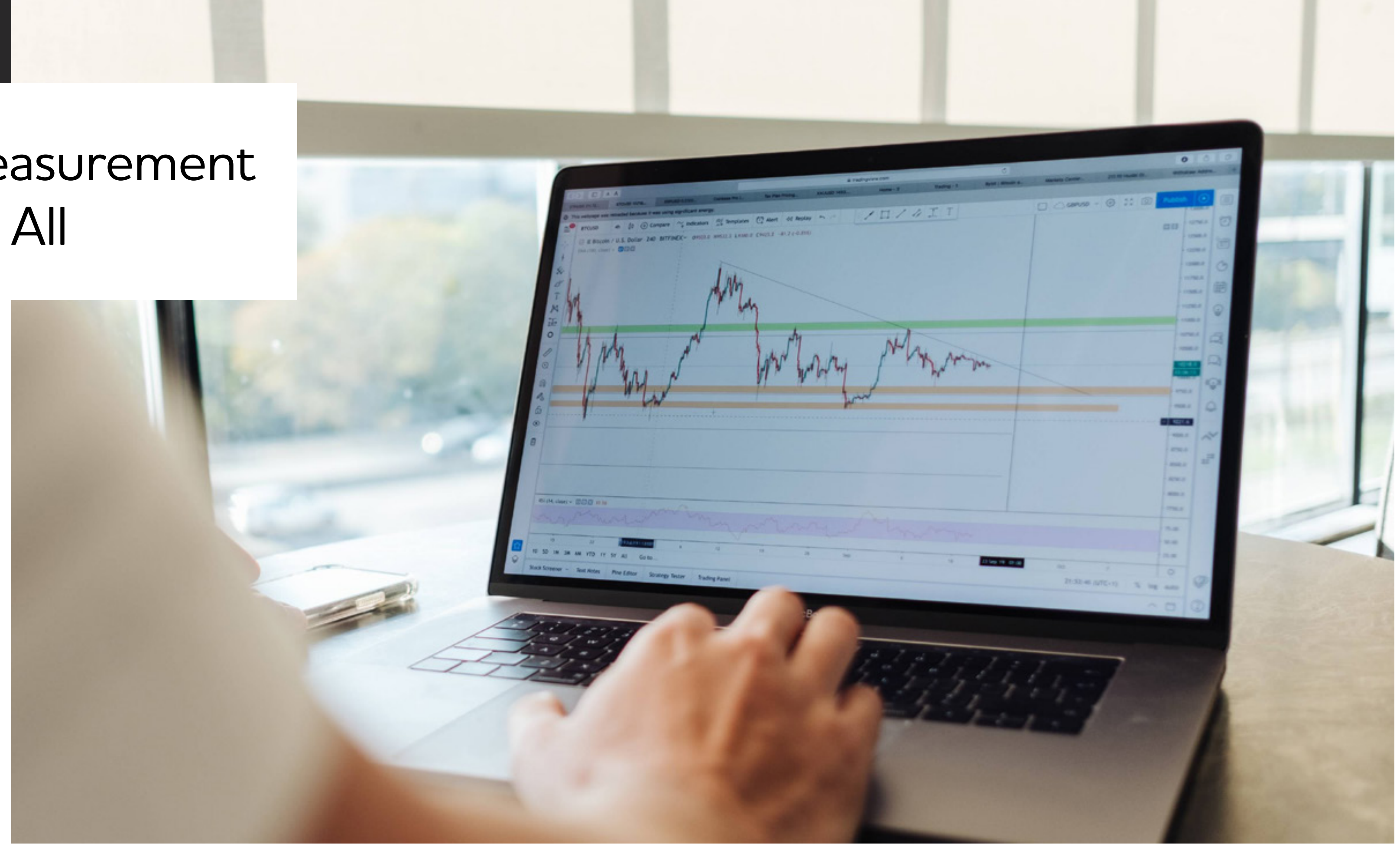
Associate Director, Palladium



ABOUT THE AUTHOR
Katharina is Senior Editor of The Catalyst and contributes to Palladium's global brand, marketing, and PR team. Based in Washington, DC, she holds a Master's Degree in Strategic Communications from American University, along with experience in journalism, marketing, and content development across multiple industries.

ABOUT THE EXPERT
Kelly Roberts-Robbins is an Associate Director on Palladium's capital advisory team. Kelly leads gender lens investing and gender smart banking programs, including strategy development, impact measurement, research, and gender assessments. Kelly led the development of the Gender Benchmarking Tool and its implementation in 17 financial institutions. She also conducts impact evaluations, impact reporting for investor portfolios, and designs and refines Impact Measurement and Management systems (IMM) for investors, funds, commercial banks, and recipients of impact investment capital.

> "You need to understand how social inclusion supports your investor impact narrative."

As the impact investing industry grows to meet the challenges of our times, so does the need for proper measurement and management of impact. It requires defining 'impact's scope' and what success looks like. It gives investors focus, and, at the end of the day, it demonstrates the value of investments and portfolios.

In the long run, good measurement allows investors to know what works and how to scale up those successes.

Part of the challenge is ensuring that measurement strategies take into account the impact on all people – what's known as 'inclusive impact measurement'. Long term problems of disenfranchisement and exclusion are receiving new and different attention as a result of activists' work in the Black Lives Matter, LGBTQI, and women's empowerment movements. This serves as a reminder across industries that now is the time to build better, more inclusive systems.

As impact investors and enterprises seek to establish and improve their impact measurement, Kelly Roberts-Robbins, Associate Director at Palladium Impact Capital (formerly Enclude), argues that there is a crucial opportunity to build more socially inclusive and intersectional investing into an overall strategy.

"We all know it's a challenge for investors with existing impact goals, such as combating climate change, to also be experts in knowing how to measure and manage social inclusion," she explains. "But instead of adding additional priorities, you need to understand how social inclusion supports your investor impact narrative."

This is easier said than done. Roberts-Robbins acknowledges that the field has some growing pains to work through, especially when it comes to measuring impact. But without a proper means, there's no clear way forward for organisations that want to understand and improve upon how they're affecting the lives of those in their communities and eventually broaden their focus.

She clarifies that one of the stumbling blocks is that, for many organisations, the way impact measurement is typically designed is not helping investees to increase their impact. "There's some awareness about the risk of over-burdening investees with reporting requirements, but little focus on how measurement can be beneficial for investees as they scale and innovate," she says.

MAKING MEASUREMENT MORE ACCESSIBLE

Revamping impact measurement to be more inclusive should also make it more useful. Reporting and measurement serve a purpose in signalling investors' priorities. But in studies Palladium's capital advisory team has conducted, nearly 100% of investees report that they never hear back from investors about the gender metrics on which they report.

> "Inclusive and intersectional investing and measurement goes well beyond early ideas that a gender lens is all about women."

Investees are often left hanging, without a clear understanding of how that information is analysed or any knowledge on whether they are doing well, or even how they could improve their business or deepen their impact.

Roberts-Robbins shares this example:

A fund-of-funds is using inclusive measurement with a fund in which they've invested. That fund is cascading the reporting requirement down to their investees, which are enterprises. In this sense, inclusive measurement is making its way through the capital chain. But is it helping? No feedback ever truly makes its way to entrepreneurs or the fund and they essentially remain in the dark.

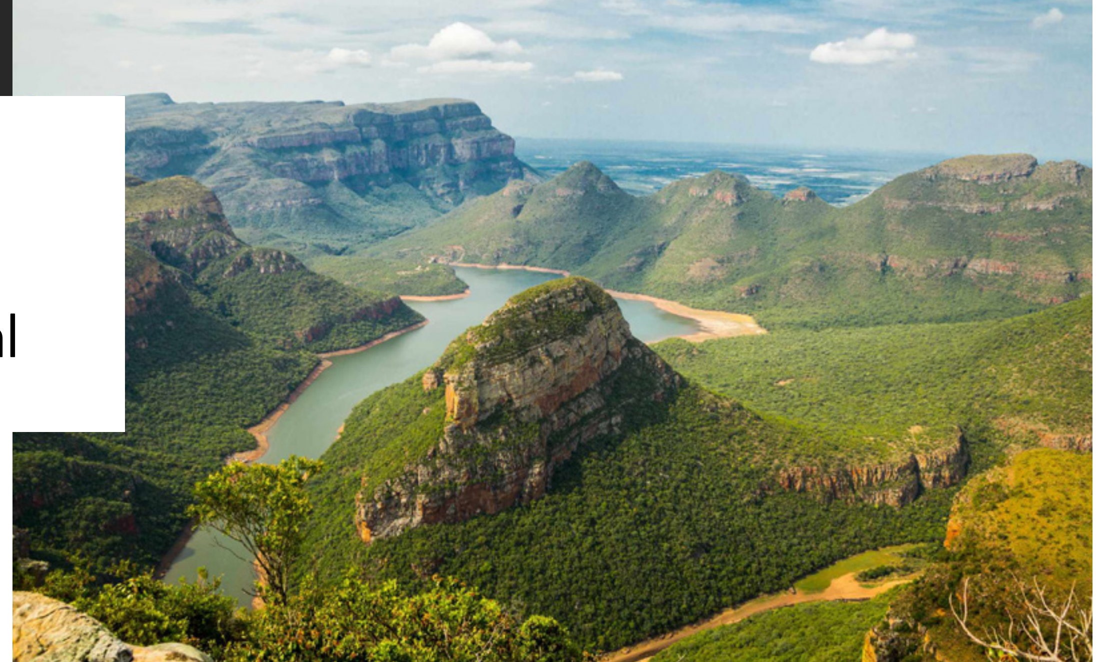
As Steven van Weede, Palladium Managing Director observes, it's critical to ensure that metrics are helping investees improve their business in some way – such as helping find new clients by serving as a positive screen. "This is crucial support impact investors can provide, and it should be common practice to give feedback - or even training - to really help drive impact," he says.

Positive screening is just one of many tools that, when implemented, can provide investees with more inclusive data. For instance, the fund in Roberts-Robbins' example might actively seek out or prefer entrepreneurs of a particular profile. Without the right data, the chosen profiles might be considered too risky a group in which to invest.

Inclusive impact measurement at the fund-of-funds level can access that data by analysing several funds at once. By sharing the anonymised results with each fund, they are putting the data in the hands of the decision-makers finding the entrepreneurs and distributing capital. The data helps fund managers know whether it is worth it to seek out entrepreneurs of this type, and empowers them with the knowledge that their businesses are likely to innovate and succeed.

Inclusive and intersectional investing and measurement goes well beyond early ideas that a gender lens is all about women. Inclusivity inherently means strengthening and broadening that lens to include and address racial equity, LGBTQI community members, and entrepreneurs of all genders.

For those investors that are already implementing a gender lens strategy, utilising inclusive measurement is not only a clear next step, but will serve to expand social impact overall.



Time to Invest in Africa's Green Growth Potential

BY
Andrew Ireland
Palladium

ABOUT THE AUTHOR
Andrew is a Senior Associate in Palladium's Economic Growth practice. Based in Washington, DC, he provides technical support to business development and project delivery efforts in agriculture, governance, innovative finance, and natural resource management. He holds a Master of Science in Foreign Service from Georgetown University and is passionate about supporting inclusive and sustainable growth both in the U.S. and abroad.

> "The $2.5 trillion annual financing gap for achieving the SDGs seems less like an insurmountable barrier to action, and more like a unique opportunity to generate shared value for shareholders, communities, and ecosystems alike."

Among the many transformative events of 2020 so far — from COVID-19 to the renewed Black Lives Matter movement in the U.S. — another important shift is gaining momentum, while attracting relatively little attention. Five years after the adoption of the U.N. Sustainable Development Goals, corporations and governments around the world are beginning to take concrete steps to disclose and rectify the social and environmental impacts of their operations. Companies from Apple and Microsoft to Blackrock and Delta Airlines are increasingly reshaping their global supply chains to address sustainability concerns and support the well-being of local communities, while committing to more ambitious emissions reductions targets on shorter timelines. Meanwhile, governments are continuing to grapple with how best to fulfil their commitments to climate change mitigation and biodiversity preservation. For example, the European Union plans to set a carbon cost for imports as soon as next year.

Moreover, the investment community at large is in the midst of a sea change in the kinds of assets that financial institutions are willing to hold. Concerns over the reputational and long-term financial risks of carbon-heavy investments have led more than 1,200 organisations worth over $14 trillion to divest either partially or fully from fossil fuels in recent years. This includes institutions with major endowments — such as the Norwegian Sovereign Wealth Fund, Ireland's Strategic Investment Fund, and New York's Pension Fund — as well as an increasing number of colleges and universities in the United States. Large corporations have also begun to integrate this thinking into their own strategies. Microsoft, as part of its climate change commitments, has announced a $1 billion Climate Innovation Fund to invest in new carbon mitigation and removal technologies, while Apple has committed to creating a "carbon solutions fund [that will] invest in the restoration and protection of forests and natural ecosystems globally."

MOVING BEYOND CORPORATE SOCIAL RESPONSIBILITY

Increasingly, these investments are not viewed as Corporate Social Responsibility-related giveaways, but rather viable opportunities to earn real returns. The IMF recently found that so-called "ESG" funds — those that incorporate environmental, social, and governance principles — perform at least on par with conventional funds, and companies with better ESG performance generally experience lower costs of capital and generate better future financial performance. At least two dozen investment funds have already dedicated over $2.5 billion to "green growth" opportunities in agriculture and forestry alone, and a recent analysis from the World Economic Forum (WEF) found that working to protect and restore the world's natural capital could generate business opportunities worth $10 trillion per year and create 395 million jobs by 2030.

This shift has also been driven by a growing understanding of the risk that the status quo poses to the global economy. In the WEF's 2020 Global Risks Report, business leaders and other respondents ranked the global, collective failure to act on climate at the top of the list, with biodiversity loss ranked third. Several other top risks, such as water crises, infectious diseases, and extreme weather, are inextricably linked to climate change and biodiversity loss. This concern for the economy's dependence on a healthy natural world is well-founded: another recent WEF report found that "$44 trillion of economic value generation — more than half of the world's total GDP — is moderately or highly dependent on nature and its services." In this context, the $2.5 trillion annual financing gap for achieving the SDGs seems less like an insurmountable barrier to action, and more like a unique opportunity to generate shared value for shareholders, communities, and ecosystems alike.

WHY GREEN INVESTORS SHOULD LOOK TO AFRICA

As investors search out bankable opportunities within new green growth sectors, they would do well to look to Sub-Saharan Africa, where renewable natural capital assets account for around 25% of total wealth, higher than any other region. This figure does not even factor in opportunities to harness Africa's renewable energy resources, nor the vast array of ecosystem services that African habitats provide, such as carbon sequestration and water filtration, that are only now beginning to be properly valued and priced. Crop and pastureland, renewable energy, timber and non-timber forest products, and opportunities based on protected areas and wildlife tourism all have the potential to generate returns in perpetuity, if managed properly. And, with the right business models, ventures that tap into this economic potential also benefit local communities that depend directly on these assets, generating job opportunities, boosting incomes, increasing resilience, and incorporating the voices, perspectives, and expertise of indigenous and other resource-dependent communities.

> "Impact investors looking to support long-term and sustainable economic development throughout Africa would do well to focus on the natural capital opportunities available to investors."

HOW DONORS CAN HELP

In this context, donors and impact investors looking to support long-term and sustainable economic development throughout Africa would do well to focus on the natural capital opportunities available to investors. The business case for investing in Africa is increasingly clear, and, as investors explore how to replace newfound gaps in their portfolios left after divesting from fossil fuels and other reputationally and operationally risky assets, donors should be prepared to provide them with the information, networks, pipeline, and technical support to move beyond "impact-neutral" alternatives to invest in African opportunities that proactively generate positive impacts.

Donor support to these potential deals should particularly focus on applying blended finance to lower the risks associated with such investment opportunities, such as untested business models, longer return horizons, and high implementation and scaling costs. From the forests of the Congo Basin to the highlands of Ethiopia, opportunities abound throughout the continent to invest in green growth sectors such as eco-tourism, sustainable timber operations, non-timber forest products, forest restoration, and increasingly, ecosystem services via carbon markets and water funds.

Such investments, when approached and structured properly, contribute to investors' triple bottom line, while helping them respond to consumer demand for products that support, rather than damage, communities and the ecosystems on which we all depend. Palladium's experience developing innovative financial instruments for enterprises focused on tech-enabled micro-forestry in Kenya, marine conservation off the coast of East and West Africa, and sustainable natural rubber production in Indonesia have shown that creative partnerships and approaches can help first movers overcome such barriers, generating demonstration effects that then bring additional investors to the table. Meanwhile, our own investment in the restoration of 40 hectares of forest in the Peruvian Amazon — allowing us to achieve carbon neutrality while supporting local indigenous communities in applying sustainable agroforestry practices on their lands — is generating important lessons learned, applicable to similar collaborative efforts around the world, including in Africa.

As the world begins to "build back better" in a post-COVID economy, the international community has a rare chance to help the private sector use its unparalleled resources to generate social and environmental impact alongside continued financial returns. Africa, with its significant endowment of natural capital, should be a region of increasing interest to these organisations, and donors are well-positioned to support investors to engage in these markets, creating jobs, boosting incomes, improving well-being, and protecting the natural world for decades to come.

Funding Clean Energy Access is the Gateway to Closing the Digital Divide

BY
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Managing Partner, Bamboo Capital Partners

ABOUT THE AUTHOR
Florian leverages his extensive background in start-ups, fundraising, and transactions in healthcare and life science to invest in, build, and (re-)position organisations in the competitive global marketplace. As Managing Partner of Bamboo Capital Partners, the Asset Management arm of Palladium's Impact Investing business, Florian's passion is working with impact investment creating high-performance teams.

Energy is a basic need, yet in many places around the world, people go without access to reliable energy in their homes and common neighbourhood spaces. In Africa alone, over 590 million people were without reliable electricity access in 2020. It may seem like a given, but the longer people are without access to energy, the wider the digital divide grows, leaving countries, economies, and innovation behind.

But how do we solve for it?

To start, we know that solar is the cheapest and cleanest energy to produce and that it provides longevity as we shift towards a net zero economy. But there's still a need for the infrastructure to support it, and that's where investors willing to get creative and willing to take risks can step in to create smarter, more connected economies.

With distributed, rather than centralised power, comes huge opportunities. Who

> "And while some may consider funding clean energy risky, it should really be viewed and applied as catalytic risk taking, a partnership between investors and those benefitting on the ground."

benefits? The micro-businesses, the small mom and pop shops, the tiny local businesses that suddenly get to participate in a much bigger way in the economy. These villages suddenly become smart villages, and not just with traffic and streetlights, but with access to the rapidly growing and expanding IoT (Internet of Things). Suddenly people have the digital infrastructure to build upon, grow their business, and enter the commercial sector.

There's a snowball effect, and energy and connectivity effectively provides a segue to so many other things, from basic services, to increasing safety through better lit streets, improved access to water pumps, and even energy for running small cookstoves in homes.

It has to start somewhere, though, and, while some may consider funding clean energy risky, it should really be viewed and applied as catalytic risk taking, a partnership between investors and those benefitting on the ground, and an opportunity to shift the industry into the future, leapfrogging over decades of outdated technology.

FUNDING ENERGY ACCESS

When it comes to funding energy access globally, putting money behind traditional energy grids will not be enough to provide universal access. Traditional models, while important, require extensive infrastructure installations and can be expensive, especially when bringing energy via hardwiring to remote areas of the world, and, are almost never profitable endeavours. It's all about finding the right mix between grid extension, mini-grid, and solar home systems – to accelerate access to energy in the most efficient way. But for homes with low energy needs, a distributed model is a far more affordable and pragmatic solution.

Take for example, Togo, where the government mapped out 300 of the poorest villages with no electricity, and put out a call for companies that could provide distributed energy services. Keeping in mind the fact that, once a household has access to energy, their income gradually increases over time. The joint venture offered finance services over 18 months and a subsidy covered the rest for 3 years. By that time, the hope is that households could afford to pay the full cost of the energy access.

In this case, the customer simply paid for the infrastructure with mobile money, be it a solar powered cell tower or solar home units, while the funding from the government subsidies and private finance covered the rest. The subsidy and mobile money mean that the process is completely transparent, and the technology associated with it means that it's easier than ever to track how much power is being used and measure the performance of the hardware, and creating a credit history for the end user.

Projects such as these are proving that there's an opportunity to scale transformative impact and financial terms for people locally, while still creating profit on the other end.

> "Economic inclusion, which is, in turn, fuelled by digital inclusion, cannot be based only on investments backing up traditional infrastructure."

Economic inclusion, which is, in turn, fuelled by digital inclusion, cannot be based only on investments backing up traditional infrastructure, it will only occur when we begin making more 'risky' investments in small companies on the ground that are working to provide innovations that close the digital divide and truly make a difference in their local communities.

Closing the Funding Gap for Black Female Entrepreneurs Won't Happen Without Purposeful Change

BY
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Associate Director, Palladium

ABOUT THE AUTHOR
Anastasiya is an Associate Director on Palladium's capital advisory team. Based in New York City, she provides capital advisory services to social enterprises raising growth capital and investors looking to mobilize capital towards impact in more effective and innovative ways. She holds a Masters in International Trade, Finance and Development from Barcelona Graduate School of Economics, and is passionate about enabling entrepreneurs to raise the capital they need scale their impact.

The number of women-owned businesses is rapidly growing and among them, Black women have become one of the fastest growing segments of entrepreneurs in the US. But lack of access to finance and financial services is repeatedly identified as a major constraint for women business owners. The problem is further exacerbated for Black Female Entrepreneurs (BFE) as they are likely to face barriers because of their race and gender.

BFEs are one of the fastest growing entrepreneur groups in the US, yet they receive a disproportionately small amount of investment. In 2019, less than 9 percent of investment went to female founders, and less than 3 percent went to founders of colour in the US. Though the number of BFEs is also increasing in the UK, only 0.5 percent of start-ups with European Black founders received venture capital (VC) investment.

What's the solution?

In late 2020, The UK Foreign Common & Development Office (FCDO) and Department of International Trade (DIT) commissioned Palladium's capital advisory team to work on a study that builds market understanding of this critical issue by estimating the investment gap, identifying the barriers to capital flow, and proposing actionable solutions that can be implemented by FCDO and other stakeholders, with a goal to close the gender and ethnic equality gap in the investment space in both the US and UK.

"There's an opportunity in creating markets that are more inclusive of underserved communities and markets. Black Female Entrepreneurs deserve fair access to resources and opportunities and have the potential to generate lasting, positive change in our society," notes Palladium Managing Director, Steven van Weede.

> "As long as the investment processes and decisions are conducted by groups of white men, we will not see meaningful change."

What the team found was not only an issue of supply, but the sheer amount in which the supply was lacking. The demand for capital is clearly there, as demonstrated by the size of the investment gap found in both geographies, but supply is sorely lacking. And BFEs have difficulty accessing the most commonly available financing instruments for micro, small, and medium enterprises. Among other challenges, there's a clear lack of early-stage and seed capital and a frequent mismatch of current common investment instruments with BFEs' business models and needs. Furthermore, for a variety of reasons, some BFEs prefer to not engage with external investors.

Figures are very hard to come by, as data is not collected at this level of disaggregation. But, in order to get a handle on the size of the problem, Palladium extrapolated the data that is available to come to an (admittedly very rough) estimate of capital demand from BFEs at USD 14 billion in the US and USD 3 billion in the UK. More importantly, the research demonstrates that less than 15 percent of that demand is met in the US, and only 6 percent of the demand in the UK.

WHEN SUPPLY FALLS SHORT OF DEMAND

To exacerbate this system's issues, the above factors are also combined with both conscious and unconscious biases from investors who often lack understanding of the markets BFEs serve and whose processes are not inclusive of their needs. This remains a massive barrier to ensuring BFEs receive critical financing for their businesses. The solution will require a systematic change from the fund level, down to the means and ways data is collected to determine impact and results.

"The interconnectedness of systems is increasingly recognised in the sector," adds van Weede.

"Individual interventions, whilst still obviously important and worthwhile, are not able to achieve wholesale change at a systems level. Until we look at issues such as these through a systems lens, we will continue to only scratch the surface."

For this type of a systems change, an intentional and coordinated effort is required by the ecosystem stakeholders. With the support of capacity providers, investors must do the work in analysing and changing investment practices towards greater inclusivity, while asset owners must set clear intentions for their capital and demand higher diversity and inclusion standards from those they support.

This purposeful change in investors' investment processes is at the heart of addressing the broad spectrum of barriers to investment flow faced by BFEs. Many investors do not have sufficient knowledge and understanding to evaluate BFE business models, target markets, or target geographies. And if they have the knowledge, their organisations often do not have adequate tools to evaluate BFE businesses for investment opportunities.

> "This is not just a matter of equity, there is ample evidence that confirms that diverse teams lead to better decision making."

"As long as the investment processes and decisions are conducted by groups of white men, we will not see meaningful change. The case for increased diversity in investment teams and investment committees has been made for some time, but actions have been slow to follow. This is not just a matter of equity, there is ample evidence that confirms that diverse teams lead to better decision making."

But creating that purposeful change is easier said than done. That change first begins with deploying catalytic capital at the fund level, an essential tool for bridging gaps in the market and achieving impact, while still complementing conventional investments. Comprehensive capacity building for investors to truly understand and better serve markets in more inclusive ways is a critical next step, while investment processes and requirements are rebuilt to enable greater inclusivity.

There is also a need for funds to encourage more open conversations around investor bias to support understandings of perceived risks versus real risks, which proved to be a consistent barrier brought up in conversations with investors.

For funds to move forward with more inclusivity, there is a need to implement risk assessment based on alternative data sets that truly enable the separation of perceived versus real risk and can support investment structures that are better aligned with BFEs' needs. These can include alternative equity instruments with structured exits to allow entrepreneurs to maintain company ownership, or mezzanine debt with repayment tied to revenue or cash flow rather than collateral of founders' assets or guarantees.

FROM INCLUSIVITY TO IMPROVED DATA

Data, or lack thereof, continues to prove problematic for impact investing on the whole, but especially when it comes to data pertaining to BFEs. Issues of privacy and legislation that may be unintentionally blocking data collection can act as a real barrier to capital flow, or the understanding around capital flow, but doesn't mean that there isn't a way forward. Many fintech lenders are already leveraging alternative behaviour data to evaluate customers' credit risk in emerging markets; using new behaviour data sets, rather than traditional credit history and borrower assets to evaluate risk, can reduce bias and inequities inherent to many of the old models of risk assessment.

It's up to everyone in the ecosystem to support more diverse and inclusive investing but there's an opportunity for governments to be champions for change, leveraging catalytic capital in a variety of ways to support the implementation of solutions and sending a stronger signal through policy and regulatory actions to incentivise investors and asset owners to develop more inclusive investment practices.

Government can also drive a more coordinated approach to data collection and analysis, to narrow the focus of action on most critical challenges and better evaluate the efficacy of solutions.

"Most small enterprises the world over struggle with access to finance, but increased awareness and technological advances are helping to address this issue," van Weede adds.

"As we build these markets, let's make sure that we leave no one behind, and that the provision of finance becomes much more inclusive than it has been. We know what is needed, we (all market participants) now need to demonstrate a real willingness to act. In progressing this cause, we will open up a large and rapidly growing set of opportunities."

How Impact Investors Can Exit Responsibly

BY
Steven van Weede
Managing Director, Palladium

ABOUT THE EXPERT
Steven is an investment banker by training, having joined Palladium's capital advisory team (formerly Enclude) in 2014, after working in the investment banking teams at Merrill Lynch (now Bank of America) and Citi in both London and Johannesburg. In these firms, he specialised in corporate finance (balance sheet optimisation, structuring equity and equity-linked financings, and debt advisory), before taking on wider coverage roles. Subsequently, he helped set up Gryphon Investment Bank, an investment banking boutique, where he advised entrepreneurial businesses in central and eastern Europe on corporate finance transactions, including M&A, private equity financing and debt (re-) structuring. Steven has developed a particular expertise in working with small and growing businesses and determining how best to meet their capital needs to fulfill the business objectives

Impact investors go to great lengths to identify and execute investments that have a positive social or environmental impact. But how can they ensure that this impact continues beyond the life of their investment (i.e., after they've sold the asset)? The importance of a "responsible exit" cannot be overstated.

Historically, responsible exits have been to buyers that look and talk like the investors themselves (the vendors), with mission statements that sound comfortingly similar to their own. But beyond merely ensuring the continuation of an investment's impact, a responsible exit can be an opportunity to identify an owner who is even better placed than the original investor to continue to develop and grow the company's mission. If we continue to move assets from one development finance institution (DFI) or foundation to the next, we may not be moving the market forward, and, risk missing opportunities to give impact businesses the support they truly need.

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Here are three steps to achieving a responsible exit that not only sustains the original impact, but actually enhances it further, while bringing new capital into the impact investing market:

1. SET YOUR OBJECTIVES UPFRONT

The process should always start with establishing objectives. This holds for financial objectives (price), but also impact objectives. Clarity is needed where there is a single seller, but even more so where there is a consortium of sellers – where confusion over ultimate objectives may well lead to friction.

Each vendor should identify what it is the asset needs to be successful. This could be deep pockets (to support future growth), but also management capacity, licenses, geographic reach, specific networks, etc.

Do we feel the new owner needs to be a mission driven organisation, or are we comfortable that the mission is sufficiently embedded into the business model to also consider a more commercially minded owner, who may be able to strengthen the business through complementary knowledge and expertise? Have we considered offering management and employees an opportunity to buy into the business to anchor their commitment and knowledge into continued delivery of impact?

> "Having a real understanding of the acquirer's ultimate intentions – based on their strategy and actions – provides a much higher degree of comfort that the mission will be continued, and may even be enhanced."

Answering these questions up front ensures alignment and improves our chances for the best possible post-exit outcome.

2. CURATE POTENTIAL INVESTORS EARLY AND THROUGHOUT THE PROCESS

As part of early 'expressions of interest', make sure to seek information that helps come to a view on the suitability of individual bidders. Ultimately, you want to be comfortable that the new owner will continue with the mission. This can only be credible if such focus makes sense within the strategy of the acquirer. Don't look at what they say; rather, look at what they do.

Early qualification of investors, and ongoing qualification as you glean more information through the process, allows you to run a process where competitive tension is used to your advantage and where you can be confident in closing the transaction with the bidder that offers the best (financial and non-financial) terms. Where vendors leave qualification of bidders to the very end, the highest bidder is most likely to win, regardless of the consequences for impact.

3. DO NOT RELY ON POST-CLOSING COVENANTS

When documenting the transaction, you can certainly include covenants or other terms that bind the acquirer to the asset's impact objectives. These post-closing covenants should not, however, be relied on as your sole protector of the mission post-exit. Having a real understanding of the acquirer's ultimate intentions – based on their strategy and actions – provides a much higher degree of comfort that the mission will be continued, and may even be enhanced.

As Managing Director of Palladium Capital Advisory (formerly Enclude), these steps represent some key learnings over ten years of managing exit processes on behalf of asset owners in different geographies across the globe. Impact investors are looking for opportunities to create change beyond financial returns, and a responsible exit is key to making that change endure.

Investing in ‘Green Gold’:

BY
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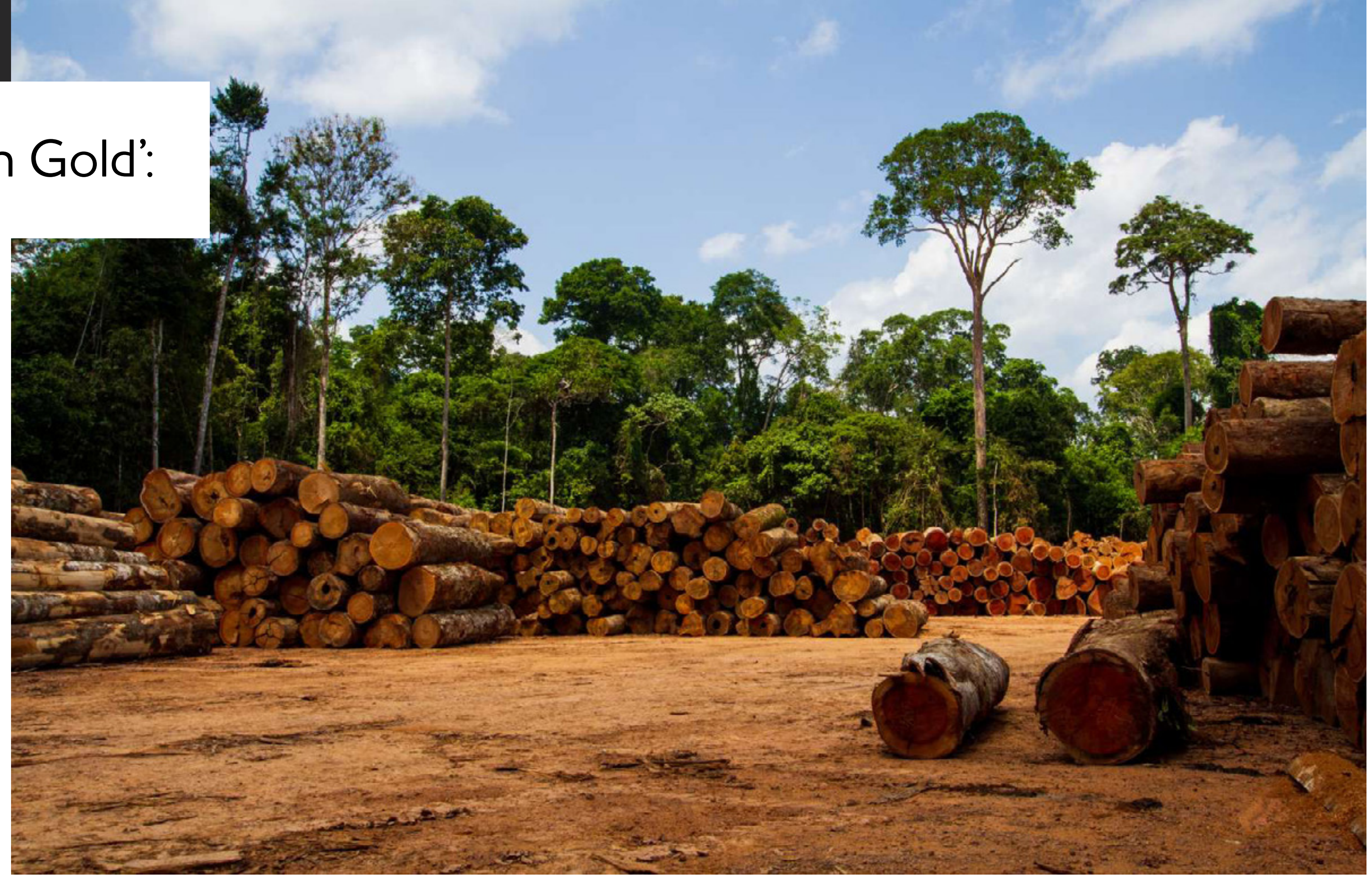
ABOUT THE AUTHOR
Jose Maria has more than 20 years of experience helping government and private sector organisations transform the societies where they operate, most recently in Europe, Africa and India. As Palladium Managing Partner in EMEA and head of Impact Investments, Jose Maria is passionate about unlocking the power of capital to deliver long-lasting solutions to socioeconomic challenges.



2021 will be the year of renewed focus on climate change. As the United States renews its commitment to the Paris Climate Agreement and the United Kingdom prepares to host the upcoming COP26 climate negotiations, climate policies must be accelerated towards net-zero, and quickly.

Industries will develop and grow in response to the ambitious climate targets set by the global community, but one of the most important shifts to emerge will be the establishment of forests as an asset class.

Forests make up 33 per cent of the solution to decarbonisation and 2021 is the year when early business models around forestry will emerge, creating enormous opportunities and drastic transformations. I predict that we will see a massive change in the level of commitment that countries are going to make against carbon emissions and the sophistication of the solutions we develop to do so.

> “Simply put, there is monetary value in a standing forest, and it isn’t just because of climate change.”

PRESERVING FORESTS

According to Partnerships for Forests, a UK-funded program that supports investments in forests and sustainable land use, about a quarter of global greenhouse gas emissions are the result of deforestation, agriculture, and other land uses. As populations, incomes, and demands for food, fuel, and fibre increase drastically, there will be an increased pressure on forests and their survival.

Reforestation is certainly required, but if policymakers and governments want to truly tackle the climate crisis, we must focus on preserving existing forests. Recent research has shown that mature natural forests store more carbon than plantation forests, but these benefits can take centuries to emerge and act on slowing the accumulation of CO_2 in the atmosphere.

Doing so won’t come cheap. Researchers from the research institute RTI International found that by 2055, it would cost as much as USD 393 billion per year to plant and protect enough trees to reduce 10 per cent of the total emissions needed to restrict climate change to 1.5 degrees Celsius.

INVESTING IN FORESTS

Where forests were once viewed as an investment liability (due to the length of time before investors see returns and because assets are often ‘illiquid’), now is the time for economic incentives and investment in the preservation and recovery of forests globally.

For billions of years, forests have acted as the world’s most effective carbon removal technology, but more often than not, the short-term economic gains from degrading or converting forests have outweighed the long-term gains of leaving them standing.

Simply put, there is monetary value in a standing forest, and it isn’t just because of climate change. These forests are worth far more standing than chopped down for timber, and traditional solutions already exist in many places.

We have the opportunity to scale up and invest in the trade of sustainable, high-value forest commodities, supporting carefully designed business models that combine high-intensity agricultural production with the protection of adjacent forests.

New solutions are emerging too: innovative business models that reflect the true value of nature’s ecosystem services. For these ideas to succeed and scale up, the right enabling environment is crucial.

They will appear in countries whose governments move first to remove the economic incentives that have long driven environmental destruction (such as subsidies for monoculture farming) and design the right frameworks to govern new markets for ecosystem services. These will likely include carbon, biodiversity and habitat creation, and natural solutions to flood risks and tackling water pollution.

The UK Government is currently setting an inspiring example for how this can be done, thanks to its new Environment and Agriculture bills, and new markets for nature restoration will swiftly emerge in the UK when these bills are passed.

When the right conditions align and these new investment opportunities emerge, the challenge will be to identify and develop projects to an investable point. Developing an ecosystem for pipeline is critical. We’re seeing the creation of more and more funds to invest in forests, but they’re struggling to find businesses ready to invest. The priority in the coming years will be to create the projects and environment

> “We’re seeing more funds to invest in forests, but they’re struggling to find businesses ready to invest.”

that allow investors to successfully deploy capital at scale for ecological restoration.

Interesting partnerships will emerge between multinationals in many sectors, governments, development organisations, NGOs, and offtakers to find the best means to invest in nature and forest preservation.

BUILDING AN ECOSYSTEM TO CHANNEL INVESTMENT

2021 will see a huge deployment of capital to forests – a transfer that requires the appropriate business infrastructure to absorb. Building a sustainable investment ecosystem that inspires growth over time will be key to mitigating the risk of an overflow of capital, which tends to create inefficient solutions and could fuel corruption, especially in countries that face governance challenges.

The crucial pieces needed for this ecosystem are pipeline development and the redefinition of economic incentives for natural capital outcomes. If governments, foundations and multinationals focus on solving for these two elements, the result would be a framework for capital to flow into businesses that protects forests and increases livelihoods in their communities.

Supporting this shift will require cooperation and coordination across the private sector, governments, and financial institutions, but it’s never been more imperative than the current moment to focus energies and investments on forest preservation.

About The Catalyst

The Catalyst is Palladium's online publication, delivering news, perspectives, and in-depth reports from the front lines of our global work. Many of the stories are written by Palladium employees and partners, sharing their experiences and expertise as they work to solve the world's greatest challenges.

The Catalyst aims to inspire, educate, and embolden all readers, from experts in international development and C-Suite executives, to impact investors and community leaders.

About Palladium

Palladium is a global impact firm, working at the intersection of social impact and commercial growth. For over 50 years, we've been helping our clients to see the world as interconnected – by formulating strategies, building partnerships, mobilising capital, and implementing programs that have a lasting social and financial impact. We simply call this "positive impact".

We work with corporations, governments, investors, communities, and civil society. With a global network operating in over 90 countries, Palladium is in the business of making the world a better place.

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