

Growing Impact In New Zealand

Impact Investment: need, practice and opportunity
September 2017

Contributions have been received from:

Foreword

Impact investment in New Zealand is now gaining enough momentum for strategic conversations to begin in earnest, and still nascent enough for the quality of these conversations to have a profound influence on the future shape and success of market development.

This report seeks to go beyond the descriptive, get under the skin of the historical, global, and strategic drivers behind this emerging market, and lay out the rationale of why impact investment and concepts of blended value are here to stay. In addition, we aim to provide some insights into the learning and practice that has developed within the field, and also propose actions that can help establish a thriving and powerful impact investment market in New Zealand.

It is fitting that this report is a product of contributors working across countries and sectors. The project has been a valuable and rewarding experience for me personally, and represents the new models of cooperation that underpin the principles and opportunity of impact investment.

Alex Hannant - Chief Executive Ākina Foundation

We are pleased to support the Ākina Foundation with the publication of this report outlining the context for the growth of impact investment and exploring the opportunities for New Zealand.

EY combines excellence in accounting standards with a deep understanding of social and environmental reporting and change strategies with a global team of Climate Change and Sustainability Services practitioners, including our team in New Zealand. We have drawn on our deep knowledge across industry sectors and experience working with clients to inform this report.

We continue to be excited as participants in the development of broader outcome, measurement and reporting methodologies and building these into the regulatory framework. As we combine deep knowledge of advanced data analysis with development of national and social capital protocols we are committed to investing in the ongoing application of tools for measuring social return on investment and lifecycle assessments that will lead to the creation of greater long-term value.

Through impact investing, new potential investment opportunities are being identified within sectors of the economy that have not previously been considered to provide investible opportunities and long-term value. In particular, we welcome opportunities that impact investment can provide for the iwi peoples in New Zealand and wish to acknowledge the contribution of our colleagues at Tahi and in New Zealand for their insights for this report.

Christopher Thorn AM - Partner Climate Change and Sustainability Services, Ernst & Young, Australia
(“EY Australia”)

Tracey Ryan - Climate Change and Sustainability Leader, Ernst & Young, New Zealand
(“EY New Zealand”)

JBWere is pleased to support the Social Enterprise World Forum and the Ākina Foundation and to contribute to the publication of this report which highlights the need for, recent growth in and future opportunity for impact investing in New Zealand and globally. JBWere’s long involvement in both the nonprofit, and in particular impact investment sectors have emphasised the need for evolving a new model of sustainable financing to achieve the social and environmental progress our society needs and deserves. Our recent report, *The JBWere New Zealand Cause Report*, highlighted the need for change in that sector as social demand rises faster than fundable supply. In addition, we have already seen great progress in the four years since we co-wrote Impact-Australia which highlighted and encouraged an impact investing approach.

JBWere enables ‘for-purpose’ organisations to enhance impact in the community through strong foundations and sound advice. Our local advisory teams work closely with our clients to provide insight and advice assisting them to achieve their wider strategic objectives and deliver on their mission.

John McLeod - JBWere Philanthropic Services
Craig Patrick - Head of JBWere New Zealand

In mid-2013, the G7, Australia and the EU joined together in a Taskforce initiated under the UK Presidency of the G8; its remit was to catalyse a global market to mobilise entrepreneurship, innovation and capital for the public good. By mid-2017, 8 more countries had joined the global effort and another 11 had concrete plans in train to mobilise leadership in their countries. In all, 550 people from 43 countries gathered in Chicago for the (now) Global Steering Group summit to plan for the next wave of action to take impact investment to a tipping point by 2020 and improve millions of lives around the globe. The idea that we can employ innovation to improve our society, attract more talent to enterprise focused on solving social issues and mobilise private capital for the public good is ambitious and bold and necessary. Congratulations to the contributors of this report; it sets the scene for the contribution that impact investment can make in New Zealand and the contribution that New Zealand can make in the region.

Rosemary Addis - Executive Board Member, Global Steering Group for Impact Investment; Chair, Australian Advisory Board on Impact Investing

I am delighted that Ākina, EY and JBWere have all contributed to this wonderful report at such an opportune time. The Global Steering Group for Impact Investment is confident that the world is headed to a Tipping Point by 2020. This requires every country, like New Zealand, to create a coalition of key stakeholders, publish great insights and reliable data, and demonstrate leadership. The report does just that while addressing the role and opportunities for all stakeholders. Impact Investment is indeed a big idea whose time has come. I am thrilled that New Zealand is weighing-in on the movement.

Amit Bhatia – Chief Executive Officer, The Global Steering Group for Impact Investment

Impact Investing Australia, (IIA) welcomes the release of this report by the Ākina Foundation and its contributors EY and JBWere as an important step in the evolution of Impact Investing in New Zealand. A similar report, Impact-Australia was launched in Australia in 2013. That report, together with the formation of an Australian Advisory Board on Impact Investing, (AAB) and the release of its strategy, Delivering on Impact in 2014, has seen growing awareness and activity in Impact Investing in Australia. Many actors from the Australian community sector, government, and the business and financial sectors are now recognising the important role that impact investing can play in both harnessing private capital for societal good and driving social innovation.

There is still much to do and IIA continues to implement the strategy of the AAB particularly in the areas of Impact Investment Readiness for Social Enterprises and the establishment of a predominantly wholesale institution, Impact Capital Australia, to bring scale to the Australian Impact Investing market. The Responsible Investment Association of Australasia, has also recently established the Impact Investment Forum, to support the AAB in further raising awareness and participation in Impact Investing.

We look forward to sharing our learnings with our colleagues in New Zealand and potentially helping to accelerate your market's development. We also excitedly anticipate the social innovation and breakthroughs that our joint collaboration, through the lens of impact investing, can bring towards better societal outcomes for both New Zealanders and Australians.

Sally McCutchan – Executive Director and CEO, Impact Investing Australia

Philanthropy is about making a difference; 'impact' has always been on the agenda. It's an agenda full of challenge, especially as we reach the limits of traditional models of resourcing social and environmental good. That's why philanthropy is increasingly adding the power of their investments to the power of their grantmaking in making the world a better place.

The global and pioneering involvement of our sector in impact investing is starting to take root in Aotearoa New Zealand. This is cause for optimism, while recognising the hard work still needed for success. Philanthropy New Zealand welcomes this report as an example of the collaboration that good work will require, and an essential roadmap for next steps.

Tony Paine – Chief Executive Philanthropy New Zealand

Impact investing is growing rapidly around the world, as capital and purpose meet each other and move beyond the scope of traditional philanthropy. Whether it's environmental impact, social impact, or a contribution to meeting the UN's sustainable development goals, people increasingly want to use their money to make a difference. And they want to do so while still protecting their capital and achieving a return – focusing on the combination of people, planet and profit. This offers a wonderful opportunity for us in New Zealand to build on the great donation culture that exists here and do more for our society, our environment, and the infrastructure we need. This report is a timely and erudite setting out of what's possible if we put our minds to the challenge

David Woods – Chair Impact Enterprise Fund, Trustee The Gift Trust, Director Whai Rawa Fund



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Executive Summary

This report provides the rationale for impact investing in New Zealand. It looks at the need for new methods of funding social and environmental impact. It shows the scale, breadth and momentum of impact investing globally, the potential for New Zealand and presents a plan for developing the field.

There is increased recognition that quality of life is enhanced in a society with positive social and environmental outcomes. This has expanded from individuals to now include businesses and investors with the themes of shared value and socially responsible investing growing rapidly. However, there is a problem with who pays for these activities. Traditionally, Government was the major source of social funding but there are limits on how much further their proportion of the funding pie can grow. At the same time, the rate of demand for social and environmental funding is outstripping broader economic growth. The new model offered by impact investing is one that produces the impacts needed, but gets financially rewarded for them and so produces a virtuous cycle.

Although Governments and individuals are supportive of the broad concept, it is only in more recent years that a variety of projects have been developed and made available to investors. This has occurred alongside dramatic growth in the pools of philanthropic capital, increasing growth in the demand for sustainable and responsible investments and improved ways of measuring and then valuing social impacts.

As this field develops, we are seeing a growing array of social causes offering impact investments and an equally growing variety of asset classes with which to invest in them. There are also a range of social impacts expected to be produced and investors can choose to focus on maximising either financial or social returns while still limiting their universe to a floor level of social impact.

There are currently US\$23 Trillion in sustainable investments globally representing 26% of all professionally managed funds. While negative screening and the use of environmental, social and governance (ESG) measures represent around 60% of the strategies used by investors, impact and community investments have grown the fastest in recent years to now total US\$248 Billion. There is also an evolving field of specific impact fund managers with which to invest for those without the considerable skills needed to evaluate both expected social and financial returns. Surveys of those managers show that they currently manage around half of all impact investments. Those surveys also indicate that the once dominant microfinance type of investment (pioneered by the Grameen Bank) have now been overtaken by housing and energy investments as larger pools of capital search for scale. This is also reflected in the location of investments with North America and West, North and South Europe now representing 54% of the fund's investments compared to only 30% in 2013.

The elements of social measurement are also expanding and becoming more formalised. We have both mainstream and impact investments measured against the United Nations Sustainable Development Goals (SDGs) and we see businesses needing to measure and respond to their social outcomes (both direct and through supply chains) in increasing numbers. Importantly we are also seeing those social measurements directly transfer to financial payments as the number of social impact bonds grow around the globe.

In New Zealand, the growth in responsible investing has been fast as some of the largest KiwiSaver providers implemented negative screening across investments. While this has yet to lead to substantial size in the impact investment market, it has been a good indicator of intentions in other countries. An analysis of the relative size of the New Zealand economy, charity sector and capital markets suggests a potential size for impact investments of around NZ\$5 Billion, a substantial increase from current levels and an opportunity to significantly increase social and environmental impact under a financially sustainable model. While there is strong interest in sustainable sources of social funding, recent surveys found a lack of knowledge about where to start or for those who had, comments on the process being difficult or inefficient were common. Nevertheless, activity and interest has continued to grow with several community, statutory and family trusts and foundations commencing impact investments.

The infrastructure for the field is also growing with the establishment of an Impact Investment Network and the formation of a New Zealand Advisory Board enabling engagement with the Global Steering Group for Impact Investment. This is in parallel with Government support through a NZ\$5.55m investment in the social enterprise sector development.

The goal of sustainable social impact is a worthy and grand target but with desire, knowledge and growing support it is an achievable one.

Introduction

In all but one of the countries surveyed for the UN's Nonprofit Handbook, *The State of Global Civil Society and Volunteering: Latest findings from the implementation of the UN Nonprofit Handbook (2013)*, the nonprofit sector has grown faster than overall country GDP since the late 1990's. *The JBWere New Zealand Cause Report*, suggests New Zealand is no different with nonprofits growing around 1% faster annually over a similar period. This growth points to the increasing demand for social and environmental services but raises the question of whether continuing growth is sustainable if the nonprofit sector continues to rely on traditional sources of funding. In both New Zealand and Australia currently this growth has mainly been funded by Government as their share as a source of nonprofit income has increased at an even faster rate alongside outsourcing of previous Government activity to the sector. At the same time philanthropy has maintained a flat income share in Australia and risen more slowly in New Zealand. There is little suggestion that growth in demand for services will slow and it is unrealistic to think that Governments can continue to fund an ever-increasing share of nonprofit sector income. This presents a problem.

The obvious answer to growing the availability of social and environmental solutions is through a combination of

- Existing nonprofits finding new funding avenues
- New organisations (both for profit and nonprofit) creating sustainable models which produce both social and financial returns
- Other parts of society and the economy becoming more aware of, measuring and increasing their positive social and environmental footprints

While this is already starting to occur in each of these three areas, one of the common elements to the solution is to be able to measure and then match the better social outcomes to a financial reward. When this is done, the solution becomes sustainable and scalable. This blending of financial and social returns and enhancing the social output of capital markets is at the heart of the nonprofit sectors and indeed society's future.

In many ways, this is not a new concept. The nonprofit sector has long earned income directly related to goods and services provided. There has also been a small but growing cohort of social entrepreneurs driven by the social but funded from success. Additionally, there is a fast-growing awareness from both the business and household sectors of the need for and advantages of including social and environmental impacts when considering how they undertake their various activities. What is changing is the urgency of these measures, the breadth of activity and the range of interested and active participants.

This report highlights the progress being made globally, closer to home and in New Zealand itself and offers thoughts on what needs to happen next to maintain the current momentum.

Specifically, we revisit aspects of history and the growing convergence between the roles of nonprofits, corporates, Governments and households and investors.

We then examine the strong recent growth in activity and sophistication of including environmental, social and governance (ESG) measures in mainstream investment analysis. This has been in parallel with the growth in specific funds being established to invest for impact while also delivering financial returns to investors. We show the growing range of impact themes across all asset classes that can now be accessed and how this has evolved from the once dominant microcredit activities to the current growth in housing and energy opportunities. We also look at the increase in other structuring instruments and financing models, including social impact bonds, which directly link social outcome to financial returns.

While opportunities for impact investment activities will vary greatly, we have included a section on "How to do it" covering some of the more challenging aspects, namely measuring social outcomes and getting paid for them.

Finally, we have included an estimate of the potential size of the New Zealand market for impact investment and highlighted some of the current steps being undertaken to encourage this growth opportunity for increased social and environmental outcomes.

We hope you enjoy reading this report on the need for and opportunity of impact investment in New Zealand and encourage you to be a part of the journey.



Why do we need a new model?

Since the Industrial Revolution in the late 18th century, the transition from an agricultural economy to an industrial economy fundamentally changed how people lived and worked, spawning new markets, organic demand, and providing exponential growth. This new economic order at the time sparked the first consistent, sustained increase to the average standard of living.

Commentators on more recent history use this paradigm to discuss analogous shifts, where technological innovations created substantial changes to how we make a living and over time increased our standard of living by generating greater economic wealth overall. The increasing efficiency of manufacturing processes over the course of the twentieth century prompted a shift from an industrial economy to a service economy; that is, a growing number of people made their living performing services rather than creating a product.

Industrialisation was not without its problems, over the next three centuries these evolving economic orders, unified by the underlying rubric of capitalism, have exacerbated the divergence of interests of the various sectors in their pursuit of value creation.

Markets are still normalising in the aftermath of the 'Great Recession' (also referred to as the Global Financial Crisis). Increased liquidity, caused by supportive budgetary policy has led to historically low interest rates, leading to inflated valuations of traditional asset across all classes. The ensuing elevated asset prices are increasing implied risk levels which is only fueling economic uncertainty and arguably only further increasing liquidity.

In advanced economies, demand for government intervention continues to accelerate in the face of rising inequality, and the ongoing debate around sustainability and climate change. Stagnant or declining revenues are providing huge fiscal and budgetary issues for public policy struggling to adjust to these major events.

As governments seek to find both immediate and longer-term responses to these external pressures, the demands on the not for profit (NFP) sector, who are traditionally at the forefront of delivery of health and human services, only continue to grow. Combined with this, NFPs continue to grapple with the challenge of lack of appropriate funding. While on average NFPs receive over one third of funding from government, in an environment of fiscal restraint continuity of government funding can no longer be assured and availability or access is increasingly difficult to attain in a very competitive environment¹. For NFP leaders the challenge is only growing, to embrace reform, embrace attainment of scale and growth, and to respond to the demand for innovation coupled with increased service delivery. This ensuing demand for the sector to reform is rapidly evolving.

Meanwhile, many leading for profit companies are redefining their purpose and broadening measurement and assessment of their impact in society. Disruptive forces are causing organisations to reassess their strategies, priorities and reason for being. In a global, complex and interconnected business environment, many companies are realising that winning in today's market means working within the ecosystem in which they operate to effect positive change and focus on solving large-scale global challenges.

Less than a decade ago, executives rarely spoke of "purpose," and when they did it was typically focused on maximising shareholder value. Today a company's declaration that it has a purpose beyond profit is eagerly trumpeted in response to growing demands:

- From employees for work that is meaningful
- From customers for brands that inspire
- From society for companies to be responsible

This change is also driven by an increase in global uncertainty and volatility — which has significantly altered how companies see themselves and their future. "The human story as it sits unfolding now is a bit of a cliff-hanger," says Valerie Keller, EY Beacon Institute Global Leader. "Automation, digitalisation and ongoing economic and political volatility are inspiring a great searching of the corporate soul. A new idea – and ideal – of successful business in the 21st century is emerging: purposeful business."

¹Average government funding for NFP's is 38% of total revenue across Australia, USA, Canada, UK, New Zealand, Japan and Norway (Cause Report, JBWere, 2016 pages 9 and 12). In New Zealand government funding represents around 31% (The JBWere New Zealand Cause Report, JBWere, 2017 page 5). In Australia, the share provided by Government has risen from 30% to 38% over a 20-year period (and in the Australian Charities and Not for Profit Commission data for 2014 was over 40%). At the same time, self-earned income fell from 62% to 54% reflecting a greater reliance on more outsourced Government work.

These companies are prepared to compare and consider their impact, alongside their exposure to financial risk and financial return.

For investors, in a continuing global environment of high liquidity (meaning investors – both companies and individuals – have significant surplus capital to invest), impact investment is of growing interest. This is endorsed by the views of Blackrock, the world's largest investment manager, who states: "Once a niche market, sustainable investing is becoming mainstream. Whether to mitigate risks, comply with regulation or target thematic impact, demand for these investment approaches has grown considerably²" Blackrock note a 4-year growth of 135% in the United States³. The confluence of events – with far reaching consequences for all players – government, NFP, companies and investors – provides opportunity for new thinking and approaches.

Impact investment is a tool proving to be increasingly important in facilitating cross-sector collaboration to address both global and domestic challenges facing most countries. Impact investment enables capital to flow from mature, private capital markets to be invested into activities that support improved social and environmental outcomes.

By examining the way companies, government, NFPs and investors have aligned interests, it is possible to explore and observe how impact investment can create mutual benefit by bringing these economic segments together with the goal of driving greater, long term societal value.

GOVERNMENT SECTOR

Governments worldwide face enormous challenges meeting the needs of differing population demographics: in developed nations ageing populations place enormous strain on health, welfare and social services due to the rising number of non-workers in the population. Conversely in emerging nations, the so called 'youth bulge' is leading to increased pressure to deliver job-rich and inclusive growth for the next generation – today, about 200 million people globally are unemployed (United Nations data) and the World Bank estimates indicate that about 600 million new jobs will be needed worldwide in the next 15 years to absorb a burgeoning workforce.

Many governments continue to be burdened with ever more severe fiscal constraints intensified by a combination of high debt levels, shrinking and/or depleted revenue, high unemployment, stalling growth and increased demand for public expenditure – all legacies of the Great Recession that is continuing to play out across borders⁴. It should be noted that New Zealand's position is comparatively more positive than other countries given its Government debt to Gross Domestic Product (GDP) is currently at much lower levels.

Governments are also grappling with other emerging and momentous disruptions, among them technology and globalisation.

- Advances in technology have been disrupting business models for centuries. In our lifetime, successive waves of the IT revolution (PC, online, mobile, social) have democratised data, empowered consumers and spawned scores of new industries. The next waves – the Internet of Things (IoT), virtual reality, AI, robotics – promise to be even more revolutionary.
- Thanks to trade liberalisation and emerging market growth, globalisation has accelerated in recent decades. These trends continue to disrupt existing business models by creating new competitors, reordering supply chains and lowering price points. The next waves – including the emergence of Africa and a more multipolar world – will increase complexity and require flexible business models to respond to global shifts.

Meanwhile, urbanisation is increasing cities' economic and public policy clout, even as it strains their ability to grow in sustainable ways. Migration and immigration continue to have profound impacts on workforces and economic development. All these demographic shifts will require new strategies and business models.

In the context of increased demand for social services, more complex cases, rising costs and dwindling resources, public service provision of social services is also changing. Governments are taking a more collaborative role as designer and commissioner of services and shifting direct delivery of social services to the not-for-profit and non-government sector (NFP/NGO). Commissioning provides governments with the opportunity to meet the challenge of rising community expectations and falling funding by looking for new ways to provide better services.

²Blackrock has US\$4.6 trillion under management and US\$200 billion in sustainable investment strategies. Blackrock uses the term sustainable investing defined as "Sustainable investing seeks to drive positive social or environmental impact alongside financial results, allowing investors to accomplish more with their money", which equates to the use of impact investment in this report. Source: <https://www.blackrock.com/investing/investment-ideas/sustainable-investing>

³Source: Year over year growth in sustainable assets in the U.S. 2012 to 2016. Global Sustainable Investment Alliance

⁴As recently as June 2017, media reports note the scars of the global financial crisis remain. There have been trillions of dollars in losses and global debt now stands at a staggering US\$215 trillion equating to 325 per cent of global GDP. Source: <http://www.smh.com.au/business/the-economy/10-years-since-the-gfc-20170526-gwe5f2.html>, 17 June 2017.

Non-government organisations (NGOs) are increasingly being encouraged to expand their involvement in the delivery of public services. This is promoted by government as a means of diversifying service provision, promoting innovation and improving efficiency in the sector. In so doing, governments are responding to citizen demands to produce outcomes that satisfy clients, treat them with respect and fairness that is transparent and accountable and places individuals at the centre of service planning and delivery – contributing to the creation of enhanced ‘public value’⁵.

In each of these cases, competitive contracting for services is challenging the model of traditional grant aid (a gift with objectives), enabling the individual client and service providers to determine how services will be delivered. In these new social services models, government, profit and non-profit organisations are contracting with each other, taking on mutual accountability for creating public value — in essence collaborating in very different ways.

“The commissioner of public value is not just the person on the government side of the transaction, but all the people on the non-profit side too, who commission themselves to produce public value by articulating their purpose, finding support in the broader community for that purpose, and pursuing that support.”

Professor Mark Moore

Professor Mark Moore is:

- Hauser Professor of Non-Profit Organisations, Harvard Kennedy School of Government
- Herbert A. Simon Professor of Education, Management and Organisational Behaviour, Harvard Graduate School of Education
- Senior lecturer, Australian New Zealand School of Government

Making this new model of engagement successful requires:

- Client engagement: Government must know its clients and design services accordingly. This will require engaging with citizens to establish what they value most and, importantly, what adds value to the quality of individual and collective life.
- Market stewardship: Government must help providers to work efficiently and effectively by standardising applications, terms and conditions, and reporting requirements. These are all elements, beyond actual service delivery, that have a cost/time impact on a business/NFP.
- Accountability: Government must create direct accountabilities in contracts and contract management for agreed public value based outcomes, and develop measures to report on these to the public.
- Risk management: Government must improve its ability to recognise, own and manage risks. This will require a consistent cross-agency risk management framework that deals with differences in pricing risk.
- Public value management: All market stakeholders must collaborate to create public value. This means recognising it, communicating about it, and continuously improving service delivery outcomes to deliver it.
- Gaining revenue to fund public value delivery: this requires the support of multiple stakeholders, including: government, partners and stakeholders, users, interest groups and tax paying citizens. In effect, to secure the resources they need to operate, public managers must ‘sell’ these stakeholders a story about public value creation and keep communicating about progress in achieving these target outcomes.

⁵The concept of person-centred care is variously referred to as ‘direct payments’ (UK), ‘self-determination’ (USA) self-managed care’ (Canada) and ‘cash for care’ (Europe) (Department of Families, Housing, Community Services and Indigenous Affairs 2010, p.7). The concept originated in North America in the late 1980s. Sourced at <http://eprints.lib.uts.edu.au/journals/index.php/mcs/article/view/3915/4348>

This transition is creating unprecedented challenges, requiring considerable work to prepare the market for delivery – and this is common to both New Zealand and Australia⁶. In Australia, for example, an estimated \$100 billion of services will be shared with the NFP sector in the future⁷ and it is expected that the transition to these arrangements can take up to a decade, during which time the supply sector needs to be developed. The challenge for government is to build a strong public-private production system that can meet the demands of clients and achieve desired social outcomes.

New Zealand Criminal Justice System

When public sector agencies prioritise and focus on outputs and outcomes (rather than inputs), very different models often emerge. For example, in New Zealand, numerous justice sector stakeholders — The Ministry of Justice, Department of Corrections, NZ Police, Serious Fraud Office, Crown Law and Ministry of Social Development (for youth justice) worked together to address the top priority outcome to reduce crime and numbers in the criminal justice pipeline. To generate the collective desired outcome, they created a new Justice Sector Fund, which allowed savings to be transferred between agencies and across years, meaning money could be invested to best effect.



⁶For a discussion of the position in New Zealand see The New Zealand Non-Profit Sector and Government Policy, A review of the policy relationship between government and the non-profit sector, undertaken as part of the Study of the New Zealand Non-profit Sector, Mike O'Brien, Jackie Sanders and Margaret Tennant, 2009 accessed at <https://www.parliament.nz/resource/0000115081>

⁷[http://www.ey.com/Publication/vwLUAssets/EY_-_Creating_public_value/\\$FILE/ey-creating-public-value.pdf](http://www.ey.com/Publication/vwLUAssets/EY_-_Creating_public_value/$FILE/ey-creating-public-value.pdf), page 3

New funding models

In many sectors, governments can no longer afford to deliver services to meet total demand. The challenge here is to prioritise and manage demand to meet the funding envelope, or to look for new and innovative ways to fund services and outcomes. This may require public service commissioners to work with the market to co-develop completely new business models and ventures which open up new investment and funding streams, or change the way services have traditionally been funded.

In addition to the new models of service delivery in collaboration with not for profits as described above, governments continue to explore other models, with the private sector, in the recognition that public private partnerships alone, will not meet the growing demand for future services.

Pay for Outcomes or Pay for Success Social Finance instruments are an emerging alternative means of funding the delivery of outcomes. These payment-by-result contracts, require the contractor to finance and carry the risk of delivering a social outcome. “Bonds” are funded by the subsequent savings to the government from the resulting, measurable reduced demand for public services. By focusing on developing entirely new approaches to funding and operating services, governments are able to open up new opportunities for the public sector, private sector, not for profit organisations and financiers to combine their collective expertise and ideas to create entirely new approaches to doing business. For instance, to deal with access to housing and homelessness, a report from the Australian Housing and Urban Research Institute said social impact investments were an “innovative and growing mechanism” for funding solutions to complex social with some of the models being used internationally including:

- investment funds that finance property (e.g. the bond aggregator model, low income housing tax credits);
- social enterprises which generate a profit to reinvest in affordable housing or homelessness support services (e.g. some community housing providers); and
- social impact “bonds” (which are a pay-for-performance instrument where government pays on the basis of outcomes achieved)⁸.

In other examples: “vaccine bonds” have raised billions to fight disease and green bonds have financed such projects as solar energy in South Africa and LED streetlights in Los Angeles.

The International Finance Facility for Immunisation (IFFIm) created “vaccine bonds” that raised billions from capital markets. The vaccine bonds were the brainstorm of Christopher Edgerton-Warburton, a Goldman Sachs banker who identified that vaccine programs needed immediate funds but that the government aid and private grants pledged to them was often years from being available. He figured out how to turn future streams of government aid into a financial instrument.

In 2005, IFFIm lined up promises of vaccine funding from France, Spain, Italy, Sweden and Norway. With government funding assured, IFFIm issued a bond. Institutional investors purchased the bond, supplying IFFIm with \$1 billion for vaccine programs. The World Bank acted as IFFIm’s treasury manager, thus ensuring a AAA bond rating and lower borrowing costs. From 2006 through 2013, IFFIm’s average borrowing cost was just 0.83%. It used the proceeds of the eventual \$4.6 billion it raised in bond issues to fund vaccine programs through nonprofits such as UNICEF⁹.

NONPROFIT SECTOR

The nonprofit sector is facing significant headwinds in its operating environment. Increasingly being called on to manage external risk and take bold initiatives to meet demand, organisations within the sector are being expected to engage in an ever more competitive market for supporters, compounded by unsustainable growth in the number of NFPs seeking financial support.

A recent public report on the NFP sector cites charity saturation and the need for brand differentiation, an overall decline in public giving necessitating new fundraising initiatives, and the younger generation giving less and seeking experiential engagement as three areas that NFPs need to come to terms with¹⁰.

These and other trends impacting NFPs in New Zealand are explored further in the “Opportunities within New Zealand” section of the report.

First movers in the NFP sector responding to these challenges have started to explore a range of options and shifts in the external environment. Some of these include new structures and business models such as social enterprise models, for-purpose business and financial restructuring through consolidation with other like-minded NFPs (whether of organisations, programs or services) and exploration of other structured finance activities, more commonly used by the private for-profit sector.

⁸Muir, K. Moran, M., Michaux, F., Findlay, S., Meltzer, A., Mason, C., Ramia, I. and Heaney, R. (2017) The opportunities, risks and possibilities of social impact investment for housing and homelessness, AHURI Final Report 288, Australian Housing and Urban Research Institute Limited, Melbourne, <http://www.ahuri.edu.au/research/final-reports/288>, doi: 10.18408/ahuri-7110101.

⁹Source: <http://www.iffim.org/bonds> as described in Capital and the Common Good, How Innovative Finance Is Tackling the World’s Most Urgent Problems, Georgia Levenson Keohane, 2016 ¹⁰External Trends Impacting the NFP Sector in 2017, Miles, E

CORPORATE SECTOR

Between the early manifestations of the British East India Company's constructs of the modern-day corporation in the eighteenth century and the post-subprime world of 2011, the idea of the corporation was born, matured, over-extended, reined-in, refined, patched, updated, over-extended again, propped-up and finally widely declared to be obsolete. Between 2011 and 2100, the model that played a vital role in shaping the modern day as we know it has been slated to decline¹¹. In its four hundred plus year history, the corporation has achieved extraordinary things, cutting around-the-world travel time from years to less than a day, putting a computer on every desk, and a mobile phone within reach of every human. While the traditional corporation won't disappear completely it is argued that it will cease to be the center of gravity of economic life in another generation or two. The growth of the corporation over the last two centuries has been largely fueled by capital markets and the flow of public and private capital structures that have yielded short term returns for owners and shareholders.

Historically, the challenges associated with exponential growth and scale of operations of corporations compounded by the effects of globalisation have resulted in the increased separation between ownership and management. This disconnect has contributed to the focus on short termism in the myopic pursuit of economic value creation. Incentives created for management by often distant and disaggregated owners of equity, with little or no connection to the communities in which these businesses operate, has resulted in the exploitation and exacerbation of social and environmental externalities that have in turn contributed to global challenges, such as climate change, a widening socio-economic disparity, conspicuous inequality and rising populism.

In the wake of a series of internationally significant corporate failures, advocacy groups rallied to reign in the behaviour and decisions of large corporates through standards and calls for disclosure. The 1994 Earth Summit in Rio gave rise to the nomenclature of sustainable development that led to questions of a corporation's social licence to operate. Organisations responded to this increased scrutiny and public exposure by leveraging CSR and corporate philanthropy to in a bid to 'give back' and engage local communities in response to the criticism that they were disconnected to the local communities and the externalities created by their business footprint. A striking example of this was the creation of Business in the Community in 1982 in the United Kingdom¹². Initiatives such as the Global Reporting Initiative¹³ and the Business Call to Action¹⁴ have contributed towards a new discourse that is increasingly influencing civic minded and customer focused corporations to apply a stakeholder value creation lens to their strategy and approach to value creation.

In recent times leaders among the corporate community have demonstrated that using an inclusive approach to shared value creation for both corporation and community yields greater long-term value than a shareholder driven economic profit maximisation focus. Capital markets have also responded and in fact stimulated the rise of these enterprises and corporations through new forms of investment instruments that capture intangible value derived from the impact created by the corporation in society and on the environment. Business models that serve community needs and address a social and/or environmental challenge yield a more sustainable and impactful return that is increasingly becoming a mainstream investible capital raise model. The rubric of impact investing sits at the cusp of this transformation of corporations and is poised to effect another paradigm shift in the history of the corporation.



¹¹Source: Venkatesh G. Rao 2015

¹²<https://www.bitc.org.uk/about-us/who-we-are>

¹³<https://www.globalreporting.org/Pages/default.aspx>

¹⁴<https://www.businesscalltoaction.org/>

INVESTORS, HOUSEHOLDS AND FIDUCIARIES

Of the four sectors, investors¹⁵ arguably are the most conservative market participants. A key reason is the growth of the 'fiduciary' as a dominant decision maker in the investment process. Households have been willing to invest more in "impact first" relative to "financial first" investment opportunities due to their ability to value non-financial returns and accept such "returns" for non-financial motivations.

The obligation, or the interpretation of the legal obligation, to act in the best interests of the party whose assets are being managed, has led to a level of risk aversion that has impacted how capital has been allocated.

Institutional capital managers historically have held that their fiduciary mandate demands that they maximise financial return, however increasingly risk and impact are being considered in this deliberation, in the face of an era of low returns. The willingness to accept higher levels of risk, whether it be via increased illiquidity in private capital markets or through greater focus on long term value that may be monetised over time periods outside current benchmarks, will continue to grow.

Institutional investor attitude has been researched by EY and the Institutional Investor's Research Lab over the last three years, including with banks, investment managers, family offices, pension funds, insurers, foundations and endowments, regarding the use of nonfinancial information, particularly environmental, social and governance information (ESG) in investment decision-making. This research has shown broad support among investors for ESG related information across geographies and that this trend will continue to grow in importance¹⁶. More than 80% of the survey respondents agreed with four statements:

- That CEOs should lay out long-term board-reviewed strategies each year
- That companies have not considered environmental and social issues as core to their business for far too long
- That generating sustainable returns over time requires a sharper focus on ESG factors
- That ESG issues have real and quantifiable impacts over the long term

Increased awareness and investor demand is driving ethical investors and super funds, like Australian Ethical Super, appealing to a younger generation of consumers who have a greater awareness of social and environmental impact.

A Blackrock survey found: "67% of millennials say they want investments to reflect their social and environmental values. For women, it's 76%" ¹⁷and investors believe that what motivates companies most to report details on nonfinancial ESG activities is to build corporate reputation with customers.

This trend is further exacerbated by intergenerational wealth transfer that is leading to large pools of capital bequeathed to the next generation of investors. In fact, we are about to witness the greatest transfer of wealth in human history. 460 billionaires will hand down \$2.1trn to heirs over a period of just 20 years, according to a recently published UBS/PwC Billionaires Report¹⁸.

As the beneficial owners of investment capital demonstrate to the fiduciary manager the importance of an 'impact filter', asset allocation and investment choice of manager will increasingly align and change.

Philanthropic capital

Investment of philanthropic capital has traditionally been conservative in relation to management of an endowment's reserves. This has resulted in a conservative relationship in allocating financial resources to the NFP sector.

The grant making model, also a feature of government, may drive rigour for funding but it does not drive rigour for outcomes. This again has a common characteristic in the historic separation of the founder from the trustee. When establishing an endowed foundation, the founder prescribes an investment mandate and a set of objectives, which sets out the inclusions and exclusions of where they would like to see the corpus distributed. During the founder's lifetime, the mandate is easy to interpret but when the 'power to decide' is bestowed upon those who come after, the process take on a different complexion.

The fiduciary duties of the trustees often translate into a greater level of risk aversion very different from the risk profile most living philanthropists accept with their philanthropic capital. (In fact, philanthropic capital is often regarded as the most precious capital of all because of the risk it can take on, and the level of financial return required to be generated).

The notion that the corpus is put to work in a manner isolated from the mission of the endowment, while only 5% (the annual distribution) is allocated to the philanthropic objectives is a stark contradiction. For modern philanthropists, such as Bill Gates and fellow benefactors of 'The Giving Pledge' this is antithetical to what their foundations were established to do. Organisations such as these are leading the transition away from solely traditional grant making, challenging alternative

¹⁵Household investors generally have 'invested' for no financial return with contributions including volunteering, charitable donations and supporting recycling initiatives.

¹⁶Source: EY Is your nonfinancial performance revealing the true value of your business to investors? 2017. Recent scandals have driven investors in Australia and New Zealand to pay closer attention to ESG information, with 94% of the investors from that region - compared to 81% of investors as a whole — saying that they pay much closer or somewhat closer attention to nonfinancial disclosures as a result of recent noncompliance revelations. For investors in the Americas, 80% said they paid much closer or somewhat closer attention. Page 12

¹⁷Source: <https://www.blackrockblog.com/2017/04/17/millennials-save-world-retirement/>

¹⁸Source: Awaken the giant: Wealth managers should do more to unlock philanthropy. Posted: 14 Aug 2017 http://www.alliancemagazine.org/blog/awaken-giant-wealth-managers-unlock-philanthropy/?utm_source=feedburner&utm_medium=email&utm_campaign=Feed%3A+alliancemagazine%2FDeMY+%28Latest+from+Alliance%29

approaches with mission and program-related investing, impact investment and social finance.

The Ford Foundation has made the largest commitment to impact investments in the “foundation” world. Over the next ten years they have committed \$1 billion from its \$12 billion endowment to mission-related investments (MRIs).

President of the Ford Foundation, Darren Walker said, “We are making this commitment because we believe MRIs have the potential to become the next great innovation for advancing social good.”

The Bill and Melinda Gates Foundation has taken an equally innovative, yet different, approach. Bill and Melinda hold the core belief that their contribution to tackling inequality should be made in this generation and have as such invoked a ‘sunset clause’ in their foundation. This states that 20 years after their deaths, the foundation will cease to exist because all of their assets will have been distributed.

In another example Tata Trusts a charitable organisation of Tata Group founders, in India is changing its approach of giving grants to non-government organisations for social causes. Instead, it will get directly involved in implementing welfare programmes in adherence to guidelines outlined by chairman Ratan Tata last year. “We wanted to change the form of our philanthropy from one that was predominantly executed by NGOs to one where we would manage some of the projects ourselves.”¹⁹

Whether other foundations will follow this lead remains to be seen.

IMPACT INVESTMENT IN NEW ZEALAND’S FOURTH SECTOR: THE MĀORI ECONOMY

Iwi (Māori tribes) were actively engaged in trade up and down the length of New Zealand (Aotearoa) for many years prior to colonial settlement. By the 1830s, iwi were growing and milling wheat, producing butter, pork and vegetables for nearby settlements and exporting flax and timber to Australia and further abroad. The recent Treaty of Waitangi settlements from the Government / Crown to redress historical grievances stemming from its own breaches of New Zealand’s founding treaty are in part an attempt, albeit on a miniscule scale, to restore iwi to their former position as an economic force, and one that benefits all of New Zealand. Today, the Māori economy, which broadly consists of iwi economic entities, Māori owned businesses, trusts and incorporations across many industries and sectors represents an asset base in excess of \$40 billion.

Iwi and other Māori purpose businesses continue to engage in the economy with a distinct purpose: inter-generational social, cultural, environmental and economic value creation for their people. That value is predominantly generated in two ways: the skills, careers and livelihoods that tribal and Māori businesses provide through employment, and the social, cultural and environmental programmes they fund and deliver. Investing in social impacts is not a new thing for tribal entities.

Impact investment represents another tool in the ‘kete’ (‘kit’) for the Māori sector to accelerate positive outcomes in the health, wealth and wellbeing of whanau (family), hapū (sub-tribe) and iwi. Such tools could be used as an alternative source of finance where collectively owned tribal lands are restricted from being leveraged to access capital. They also represent a potential source of investment opportunities. The infrastructure supporting impact investment / social finance in New Zealand needs to accommodate and empower those operating in the Māori sector with the ability to choose whether to be fund makers, fund takers, or both.

WHAT IS IMPACT INVESTMENT?

A widely accepted definition of impact investment provided by the Global Impact Investing Network

Impact investments are investments made into companies, organisations, and funds with the intention to generate social and environmental impact alongside a financial return. Impact investments can be made in both emerging and developed markets, and target a range of returns from below market to market rate, depending on investors’ strategic goals.

The growing impact investment market provides capital to address the world’s most pressing challenges in sectors such as sustainable agriculture, renewable energy, conservation, microfinance, and affordable and accessible basic services including housing, healthcare, and education.

¹⁹Source: http://economictimes.indiatimes.com/articleshow/59276397.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst

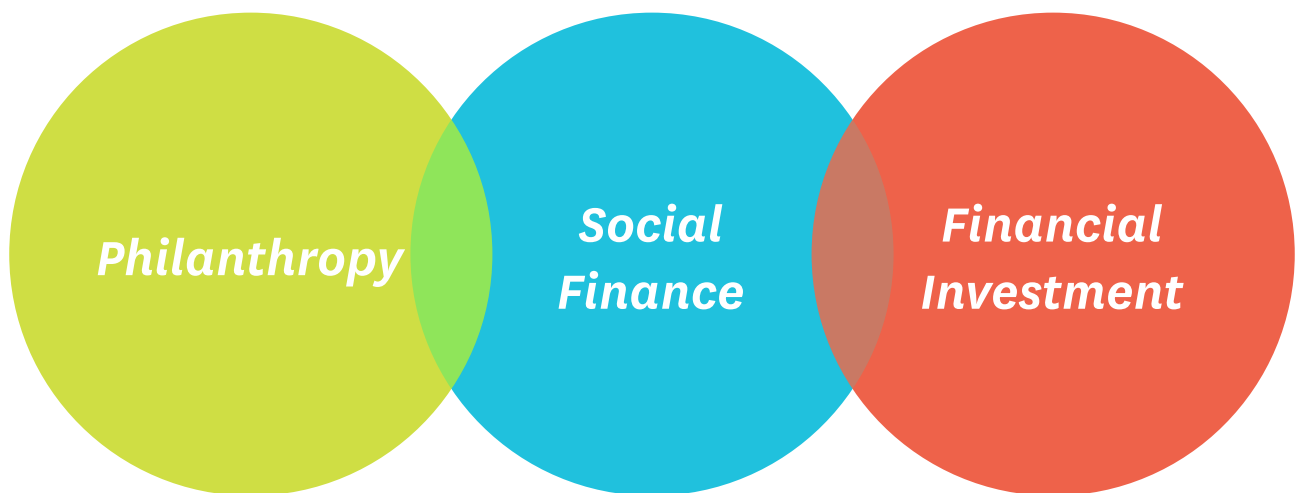
What is the role of impact investment?

Impact investment has the capacity to transcend historical investment models and economic segmentation. It is a vehicle used to align interests across the activities of the traditional silos of private companies, government, NFPs and investors. As different sources of capital seek outcomes for different reasons, impact investment is an approach that merges the traditional silos to generate blended outcomes or shared values.

Initially occurring on a small scale, often catalysed by philanthropy or social entrepreneurs, private capital is driving social outcomes. Increasing examples of, government services leveraging institutional investors are emerging, and non-profits are engaging with corporate social and environmental programs. The distinguishing characteristic of these approaches is intent.

Impact investments are defined as having the intention of generating a measurable social and/or environmental impact alongside financial return. This activity can be seen across a spectrum from philanthropy, where a financial return to the donor is prohibited, through to public capital markets, where the motivation is assumed to be the maximisation of financial return to the provider of capital as illustrated in the below figure.

Figure 1: Spectrum of investments



THE IMPORTANCE OF INTENTIONALITY:

WHAT DIFFERENTIATES AN IMPACT INVESTMENT FROM ANY OTHER KIND OF INVESTMENT IS THAT IT IS ACHIEVING AN OUTCOME THAT WOULD NOT EXIST IF THE IMPACT INVESTMENT WAS NOT THERE

The importance of intentionality:

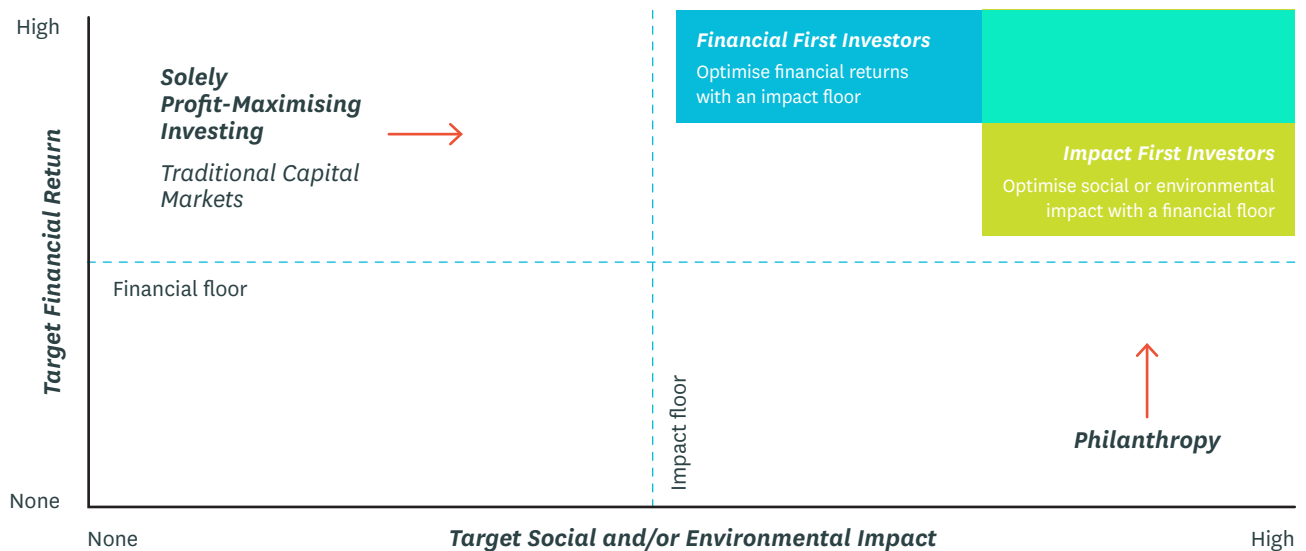
What differentiates an impact investment from any other kind of investment is that it is achieving an outcome that would not exist if the impact investment was not there.

Investors have traditionally been broadly classified into two groups based on their primary objective, irrespective of the fact they are achieving the same returns.

1. Impact first investors seek to optimise social or environmental impact, while obtaining financial returns
2. Financial first investors seek to optimise financial returns, while obtaining social or environmental impact.

The figure below shows this relationship.

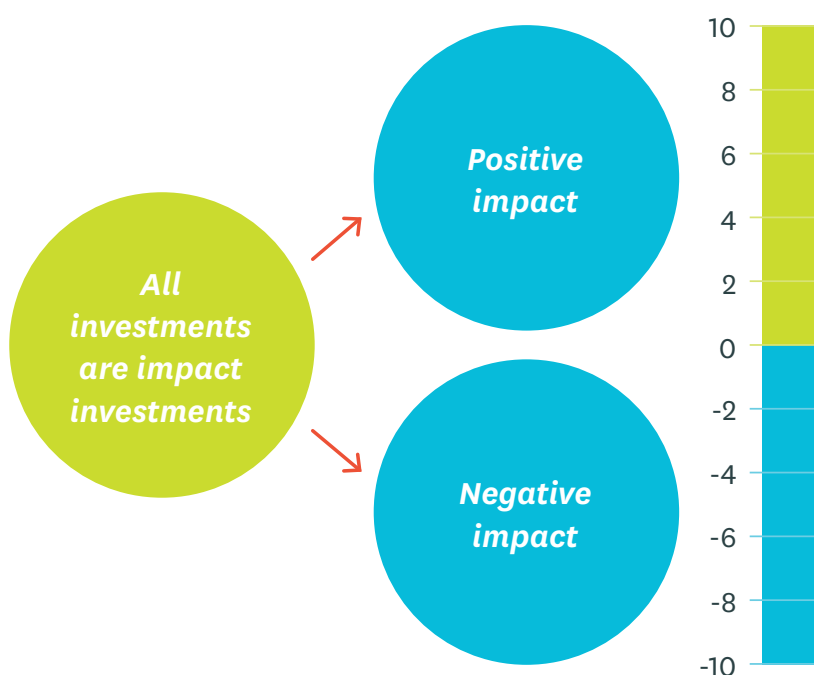
Figure 2: Segments of impact investors



(Source: Investing for Social and Environmental Impact, p33)

This feature explains why impact investing is best described as a facilitator rather than an asset class or a sector. The size of projects varies tremendously depending on the sector and geography, and as such different funding sources engage in different ways. It is a tool in the sense that it has the ability to measure previously “intangible” value.

Figure 3: The spectrum of an investment's impact



We are entering a world where every investment is considered an impact investment, with either a positive or negative effect (Figure above), and we require an understanding and an ability to identify, measure and ultimately value it. Impact investing presents the opportunity to diversify and blend different forms of investor and investment.

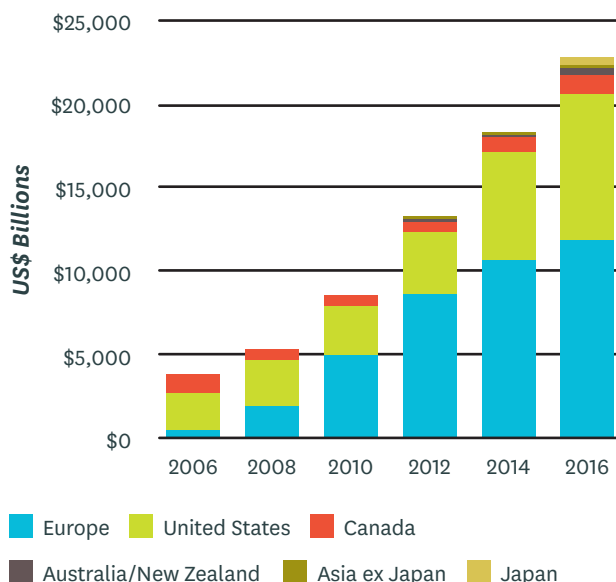
Trends in responsible and impact investing

The following part of the report details the growth and changing nature of investing, highlighting moves towards including social and environmental impacts in assessing the desirability and financial attractiveness of competing opportunities. It also explains why those focusing primarily on social impact are looking towards these areas as a sustainable and scalable solution.

GLOBAL GROWTH IN SUSTAINABLE INVESTMENTS

The interest in matching how investments are managed with responsible and sustainable themes continues to grow. This is mainly due to investors increased understanding that investing in companies or assets which consider sustainability has a positive link to their own long-term quality of life and better financial returns or lower risks. In the last decade, professionally managed funds which incorporate these themes have seen assets rise from under US\$4 Trillion to now almost US\$23 Trillion. This now represents 26% of all professionally managed funds. While Europe has continued to dominate these funds (partly through legislation requirements), much faster rates of growth are now being seen in North America and Asia/Oceania.

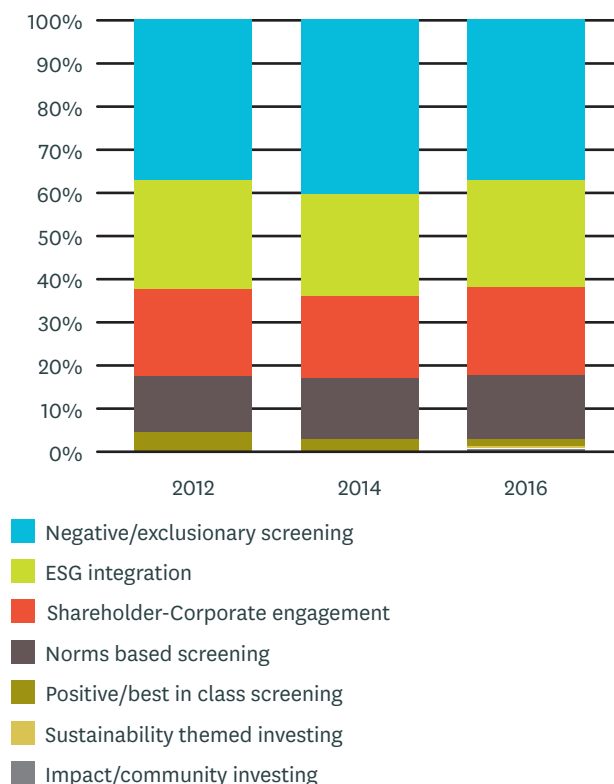
Figure 4: Sustainable investment assets 2006-2016



Source – Global Sustainable Investment Review 2012, 2014, 2016

The methods used by managers to achieve sustainability goals vary considerably although negative screening (not investing in certain industries, often for ethical/belief reasons) remains the most popular strategy. While it is still the smallest of the strategies, impact and community investing saw the fastest growth rate from 2012 to 2016 rising almost 150% to reach US\$248 Billion. The different approaches taken are often driven by the relative importance the investor places on industry themes, ethics or risk control but for those where intentional impact is the dominant requirement, impact and community investing are seeing strong support.

Figure 5: Investment strategy for sustainable investments 2012-2016

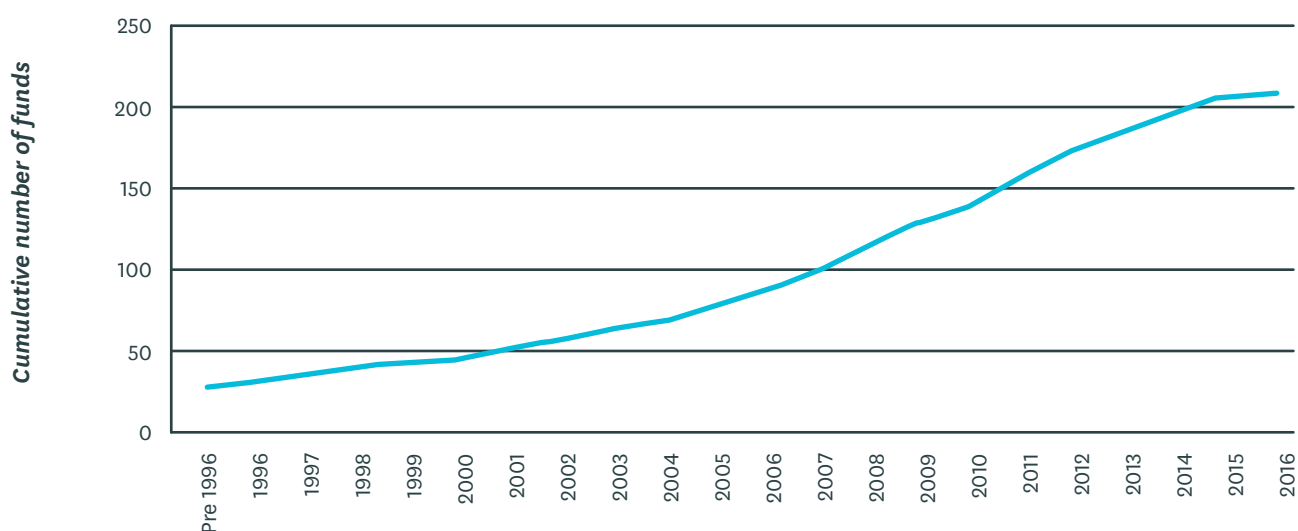


Source – Global Sustainable Investment Review 2012, 2014, 2016

THE USE OF SPECIFIC IMPACT FUNDS HAS RISEN CONSIDERABLY

When investors consider investing for impact, there are many choices available. Options vary across causes or impact themes (e.g. education, health, housing), the types of asset classes used (e.g. debt, public or private equity) and between direct investments or managed funds. The use of specific impact fund managers is proving very popular as seen by the increase in both their number and funds under management. Some of the reasons for this are around the easier diversification available and the specific skill sets in both social and financial analysis brought by their teams. The annual survey conducted by the Global Impact Investment Network (GIIN) has shown the number of funds reporting has doubled around every eight years and assets even faster (as existing funds also gain new investors) reaching \$114 Billion in 2016.

Figure 6: Impact Funds by year of first investment

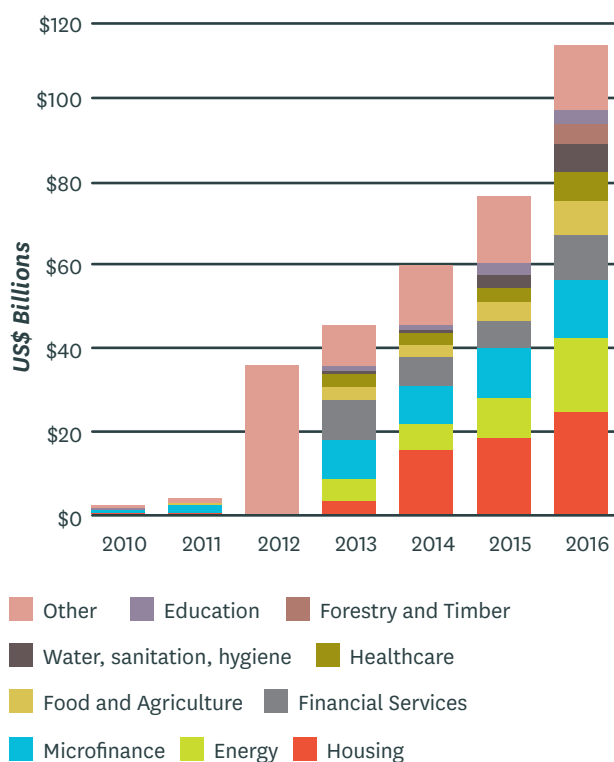


Source – Global Impact Investing Network (GIIN) Annual Impact Investor Survey 2017

THE GROWTH AND CHANGING FOCUS IN THE CAUSE AREAS OF IMPACT INVESTMENT

There has been considerable growth in both the value of impact investments and the spread in the type of cause or theme as measured by the annual GIIN surveys. There has also been a gradual change in the types of causes attracting most investment with housing and more recently energy overtaking the previously dominant microfinance sector. This is due to housing availability issues in western countries and increasing concern around climate change plus newer larger investors requiring scale that can't always be delivered in other cause areas.

Figure 7: Impact Investment by Sector 2010-2016



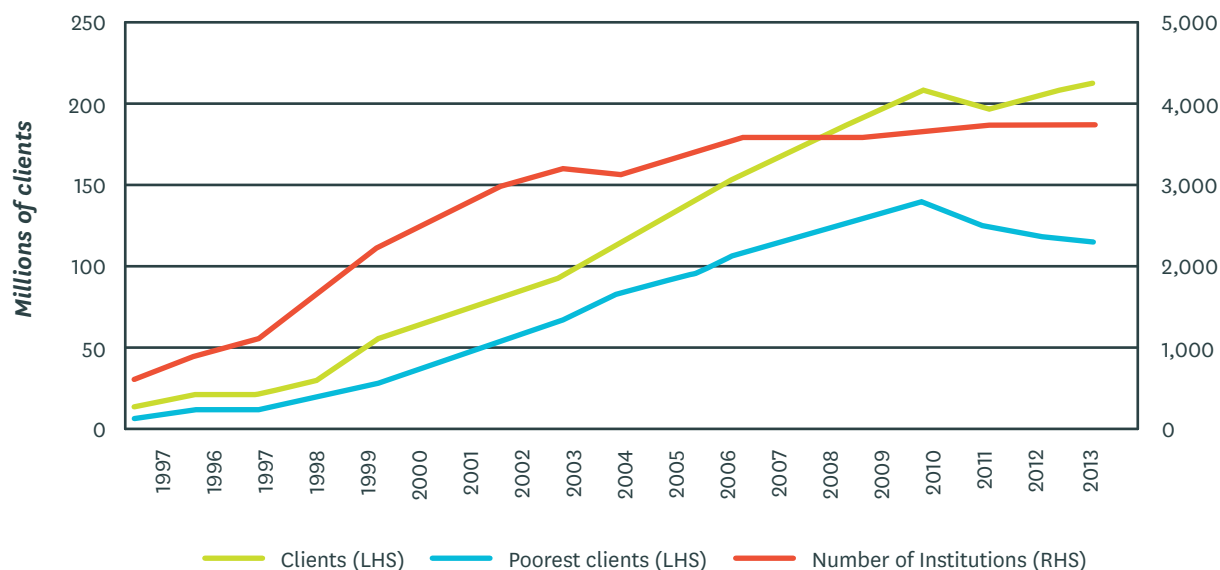
Source – Global Impact Investing Network (GIIN) Annual Impact Investor Survey 2010 - 2017

MATURING OF MICROCREDIT AS THE MAIN TYPE OF IMPACT INVESTMENT

There is little debate that microcredit has been a wonderful mechanism for bringing many millions out of poverty and into a sustainable future, mostly in third world countries but increasingly also in the west. Before “impact investing” was an accepted investment term, Professor Muhammad Yunus founded the Grameen (village) Bank in 1983 which provided micro loans, predominantly to women and started an incredibly successful movement for the combination of social and financial returns. Given the exceptional loan repayment rates and the social returns achieved, it gradually encouraged other social and then mainstream providers to enter the field.

The early adoption of microcredit as the main form of impact investing is now maturing and in 2014 we saw housing replace it as the top sector and then in 2016 energy also passed it in terms of capital employed. Microcredit remains an extremely significant form of impact investment, particularly for non-western locations but we are seeing the maturity (and long-term success) of the sector in terms of both clients and institutions.

Figure 8: Microfinance - clients and MFIs 1997-2013



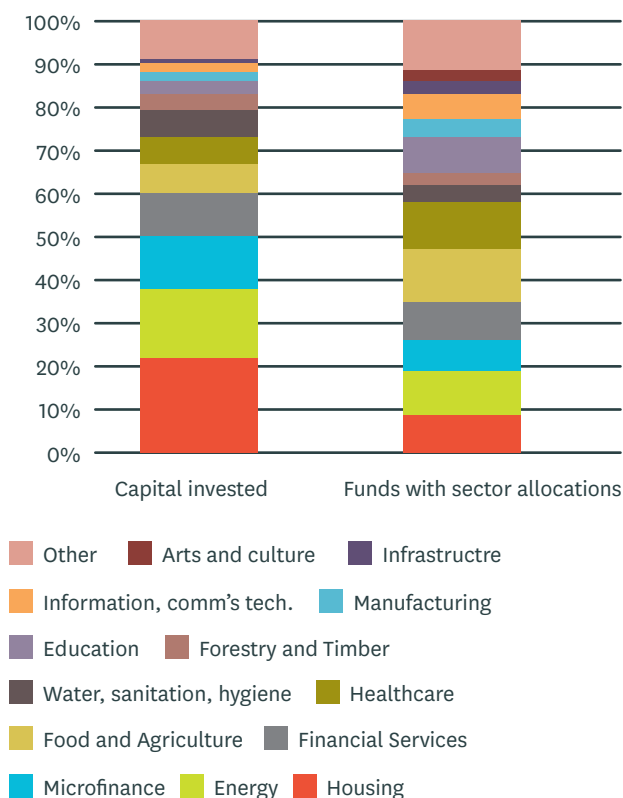
Source – www.stateofthecampaign.org

THERE ARE LARGE DIFFERENCES IN AVERAGE INVESTMENT DEAL SIZE BY SECTOR AND TYPES OF INVESTMENT

While there are many worthwhile cause themes that can increase impact through financially rewarding investments, some can absorb more capital than others. Areas such as housing, energy and microfinance have employed more capital per project than others such as food and agriculture, healthcare and education. This has implications for larger scale investors such as superannuation or pension funds which need scale to efficiently enter the impact investment market.

In the GIIN 2017 survey of impact funds, the average fund size was US\$547 million, although the median was much lower at US\$97 million highlighting the large range of investor scale. As the average individual deal size for investments made in 2016 was only US\$2.8 million, many funds are unable to justify individual small-scale deals, leading to the trend for higher capital consuming investment opportunities such as housing. This aligns well to the current demands for solutions to affordable housing and homelessness issues.

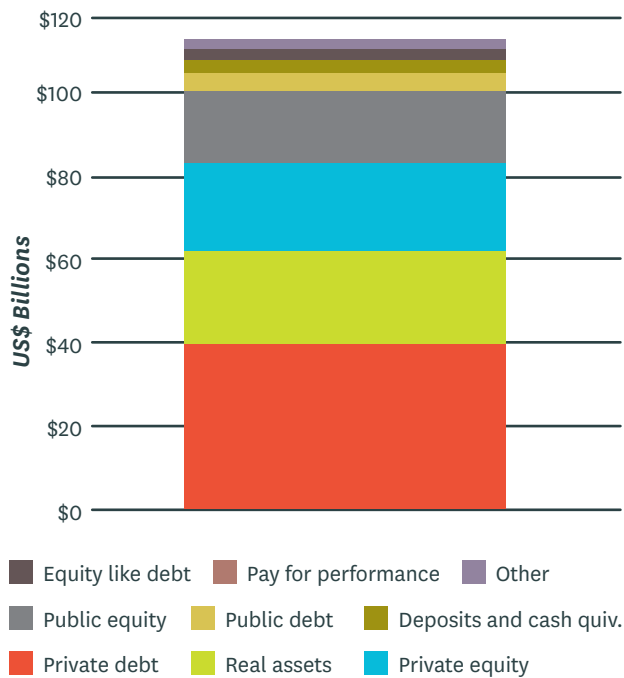
Figure 9: Sector capital invested and funds focus 2016



Source – Global Impact Investing Network (GIIN) Annual Impact Investor Survey 2017

There is also a wide range of asset classes available to investors with private deals still dominating opportunities over publicly available investments. While the private offerings still include debt, real assets and equity, their nature still requires greater individual investor due diligence than many public markets where more established analysis might be available to investors. As markets continue to evolve and grow, this due diligence “burden” will be shared by an increasing number of investors and third-party service providers.

Figure 10: Impact investment funding instruments 2016

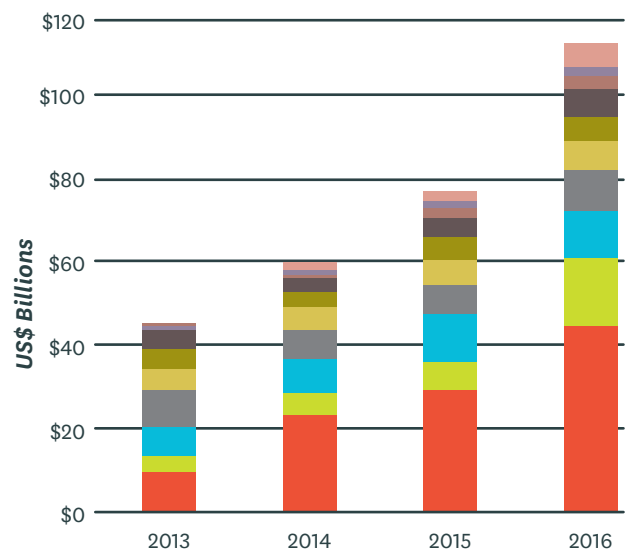


Source – Global Impact Investing Network (GIIN) Annual Impact Investor Survey 2017

THE GEOGRAPHY OF IMPACT INVESTMENTS

By definition “impact investments” target impact, so it might be assumed that the dominant location for investments would be where impact is most easily achieved and needed, in third world countries. However, when we examine the location of investments (and generally impact) we see the majority of funds are allocated to western country projects. This is partly due to the ease of linking financial returns to impact in the west but it also demonstrates the same phenomenon we see in philanthropy where physical distance to the donor is a strong guide to causes and projects supported. A similar observation can be made for impact investors and equally for mainstream investors where a home market bias is usually seen.

Figure 11: Impact Investment by Location 2013-2016



Other Middle East & North Africa Oceania
 East & South East Asia South Asia
 E. Europe, Russia, Cent. Asia Latin America & Caribbean
 Sub-Saharan Africa West, North & South Europe
 U.S and Canada

Source – Global Impact Investing Network (GIIN) Annual Impact Investor Survey 2010 - 2017

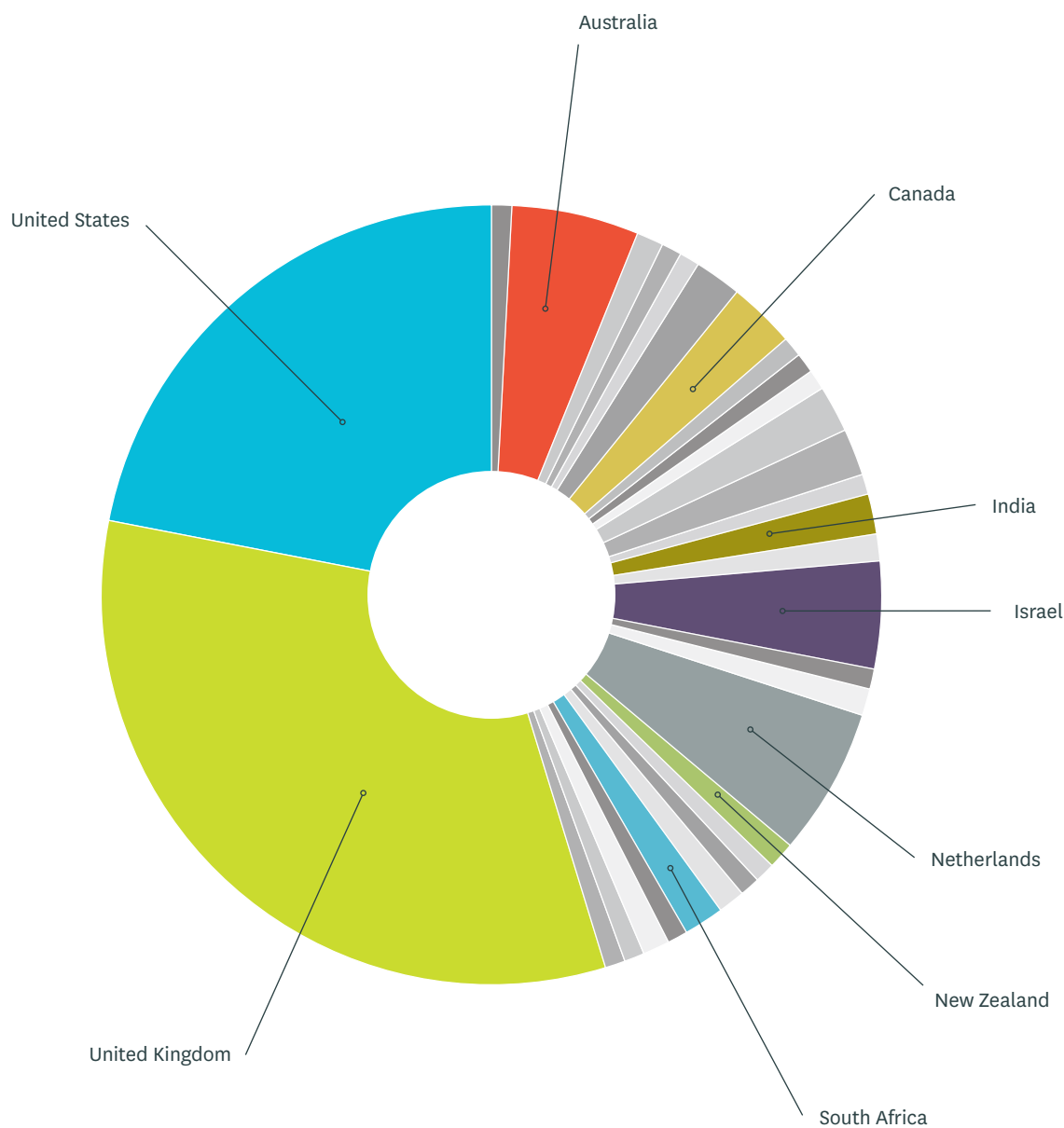


GRADUAL EMERGENCE OF SOCIAL IMPACT BONDS

The most recent survey of global social impact bonds (SIBs) shows a strong growth in the number of investable options available. We have seen a tripling in offerings over the last 3 years and a tenfold increase in the last 5 years now totaling over 100. In addition, the efforts of many Governments in exploring and promoting this solution suggests further opportunities will become available in the near future. The spread of social impact bonds globally shows that Government support for the concept promotes the development of solutions with the United Kingdom leading in the field. The formation of Big Society Capital in 2012 was the major catalyst for that regions progress in impact investing and in particular SIBs.

The cause areas are also widening as more imaginative minds find ways of linking social results and payments in new sectors, although social welfare, employment and criminal justice still lead the way.

Figure 12: Global social impact bonds by location



Source – <http://www.instiglio.org/en/sibs-worldwide/>

INCREASING RANGE OF INVESTMENT OPPORTUNITIES ACROSS CAUSE AREAS AND ASSET CLASSES

Along with increasing capital being allocated to impact investments, an important indication of growth is the expanding range of investment options across both asset classes and impact themes. The following table gives examples of the opportunities available across this matrix. To encourage a wider range of investors, it is important that this spreading of investment opportunities continues and the range of individual deals within each area also expands adding to choice.

Figure 13: Illustrative landscape of impact themes with asset class exposures

	Stable Assets		Growth Assets		Inflation Protection	
	Cash / Cash Alternatives	Fixed Income	Public Equity	Private Equity	Real Estate	Commodities, Timber & Other Real Assets
Climate Change	Green Bank Deposit	Green Bonds	Industry Screening	CO2 trading, Clean Tech Venture Capital	Green REITs	Environment rights, land conservation
Energy		Screened Corporate Bonds	Exchange Traded Funds	Renewable Energy, Energy Efficiency Venture Capital		Sustainable Feedstocks
Water		Corporate Infrastructure Bonds	Unit Investment Trust, Closed End Funds	Water Funds, Water Technology Venture Capital		Water Rights
Community Development	Community Bank CDs	Foreclosure Repair, Charity Bond	Community Development Banks, Shareholder Voting	Community Development Venture Capital	Transportation - Smart Development Funds	Habitat Conservation
Financial Services	Credit Union CDs	SME and Microfinance loan funds	Microfinance Banks	Microinsurance, financial inclusion funds	Affordable mortgage finance	
Social Enterprises		Social Enterprise Credit	Micro-Cap Listed Social Companies	Small & Medium Enterprise	Conservation/ Ecotourism	
Health & Wellness		Loan to healthcare social enterprise	Thematic Screening	Vaccination facility, Mobile clinics	Organic Farming	
Sustainable Development	Trade Finance Guarantee / Deposit	Smart Growth Municipal Bonds	Thematic Screening	Blended Debt Equity Hybrid Structures	Ranch Land, Agriculture	Sustainable Timber
Education	Linked Deposit / Guarantee	Charter school Bonds	Thematic Screening Vocational training	Education Private Equity, Early childhood learning bonds	University Green Building	

Source - <http://www.rockpa.org/resources/>

IMPACT INVESTMENTS AND THE UNITED NATIONS' SUSTAINABLE DEVELOPMENT GOALS

One of the best understood and used frameworks for areas of social and environmental activity are the 17 Sustainable Development Goals (SDGs). They cover a range of areas which overall call for action to end poverty, protect the planet and ensure all people enjoy peace and prosperity. The SDGs came into effect in January 2016 and built on the earlier Millennium Development Goals. They are guiding the United Nations Development Program to 2030 providing guidelines and targets for the 193 member States of the United Nations.

We are now starting to see investments being measured against the SDGs to better understand and categorise their areas of social or environmental focus. MSCI, in their recent report *Impact Down Under*, looked at the exposure of the constituents of their MSCI World Index for exposure to the SDGs. They found they derived 6.2% of revenue in these SDG areas and for Australian constituents it totaled only 4.9% with the main exposures being in green building, major disease treatments and nutrition. In the GIIN 2017 annual survey of impact investors, 26% already track some or all of their investments against the SDGs and another 34% plan to do so in the near future. Of those already tracking investments, their exposures to each SDG showed decent work and economic growth most common at over 80% with the average being 40%, well above the single digit exposure of listed markets.

This result highlights the much stronger focus on impact in the SDG areas by impact investments over more mainstream investments.

Figure 14: Impact investment and public equity exposure to UN SDGs



Source – MSCI Impact Down Under, Global Impact Investing Network (GIIN) Annual Impact Investor Survey 2017

A global impetus to measure impact is emerging

Reflective of the convergence of interest in social and environmental outcomes by government, corporates, investors and not for profit organisations, today, an increasing number of businesses are moving towards a blended vision of value creation and the impacts they create, including the dimensions of shared value and externalities. In the emerging economic environment, there is a realignment of resources to support the co-creation of financial and non-financial value by all organisations.

Historically, businesses and investors focused on financial value creation while government and the not-for-profit sector dealt with the social and environmental impacts, or market externalities.

Businesses and commercial organisations, in particular, have perfected the art of performance management in pursuit of the principle of profit maximisation, with the greatest efficiency, within the shortest period of time. This limited perspective of “value recognition” in the past few decades is challenged by a growing number of purpose-led organisations. They have begun to take notice of a growing body of evidence that supports integrating intangible value, expressed through alternative non-financial valuation techniques, performance measurement models and reporting frameworks.

Today, an increasing number are moving towards an integrated vision of value creation and the impacts they create, including the dimensions of shared value and externalities.

As an example, some companies have worked towards an environmental profit and loss (P&L), a social P&L or even “integrated P&L” statements.

These pioneering organisations, led by disruptors, are reaching a tipping point in making outcomes measurement a mainstream management consideration.

Coalition for Inclusive Capitalism and the Embankment Project²⁰

A compelling recent example of a response by the business community to the failure of existing economic models to create broad-based prosperity, is the movement towards ‘inclusive capitalism’.

Inclusive capitalism is a global effort to engage leaders across business, government and civil society in the movement to make capitalism more equitable, sustainable, and inclusive and improve capitalism so that it creates long-term value that sustains human endeavour without harming stakeholders and the broader environment.

The Coalition for Inclusive Capitalism founded in 2014 by Lady Lynn Forester de Rothschild, is a not-for-profit organisation, dedicated to promoting the inclusive capitalism movement. It is not just about Corporate Social Responsibility. It is about encouraging businesses to make changes and expand their investment and management practices to regain public trust.

The Coalition unites leading institutional investors, asset owners, managers, leaders of top global companies, academics, policy makers and labour representatives to help craft pathways and concrete steps that can be adopted by leaders throughout the investment and business community to make capitalism more inclusive. This approach is underpinned by solid academic research that shows that companies that follow inclusive and sustainable standards perform better for their shareholders than those that do not.

Inclusive Capitalism is fundamentally about delivering a basic social contract comprised of relative equality of outcomes, equality of opportunity, and fairness across generations. Different societies will place different weights on these elements but few would omit any of them’.

In 2017 the Coalition launched the Embankment Project for Inclusive Capitalism to transform the way businesses measure and report on the value they create for stakeholders to drive real change and progress in the workings of the capital markets.

The Embankment Project brings together over 20 global companies including six corporations across the consumer products, health services and the industrial sectors in addition to 15 investment and asset management organisations to embark on an 18-month journey to jointly develop, test and validate a long-term value framework. Combined these companies represent more than \$20 trillion of assets under management.

The project goes to activities that are at the very heart of value creation, but are not now fully captured on a company’s P&L or balance sheet – by attempting to properly value a firm’s intangible strategic assets that benefit society, as well as shareholders.

Embankment Project members statements of support

‘Long-term investment and sustainable growth models go hand in hand. Businesses must operate with purpose embedded in their strategy, serving their shareholders and wider society. The ability to articulate this in a standardised, meaningful way has long been needed so markets can properly measure this broader approach to value creation.’ Paul Polman, CEO, Unilever

‘Business must do more than simply turn a profit. We must also be guided by a deep sense of purpose. This means measuring our success not only quarter to quarter, but also year to year and decade to decade. It means creating value for shareholders as well as society. Companies that embrace this mindset will be the ones to thrive long-term.’ Indra Nooyi, Chairman and CEO of PepsiCo.

²⁰EY is supporting the Embankment Project by developing the framework that project participants will scrutinize, test and refine.

What is outcomes measurement?

The concept of outcomes measurement is simple. It is the recognition that in a complex world, organisations need to develop a better understanding of how they create value for stakeholders and society at large to be able to develop a long-term, viable strategy and to keep their license to operate.

Outcomes measurement refers to the measurement of the difference that an initiative, program or organisation makes to their stakeholders. It provides evidence on whether initiatives, programs and all forms of organisations are making a difference to the lives of people they serve. It is an important basis of learning within organisations of what works and what doesn't work.

Outcomes measurement is shifting the view that value creation is only about generating financial returns from financial and manufactured (capital) inputs. It recognises that other forms of capital such as social, human, intellectual and natural capital are critical to an organisation's long-term success, yet these are only partially, or not at all, visible in its financial accounts.

Since these forms of capital often remain invisible, the question arises whether companies, and their stakeholders, have the right information base to make decisions and mitigate risks that could affect their overall value creation.

What is driving growth in outcomes measurement?

While the concept of outcomes measurement is not new, with origins linking back to the first use of logic models and theory of change frameworks in the US in the 1950's, rapid growth in recent times is being driven by global trends.

- The shape of value has changed: globally, the majority of market value is now defined as “intangible value,” corporate reporting (as distinct from social and international development sectors who have long appreciated the importance of measuring complex intangible value) needs to catch up and review many of their traditional metrics to prove to investors that they are resilient organisations with a purposeful proposition.
- Shifts in short-term to long-term: it is no longer plausible to leave a gap between short-term commercial decision-making and the wider impacts on society (or externalities that are created).
- Increasing consumer discernment: consumers and regulators are punishing those who deplete social and environmental value more than ever.

- Access to capital and impact investment: investors are rewarding those who provide credible outcomes data on how they have not only considered sustainability risks but are actively growing their true value by strengthening human and natural resources underpinning their markets.
- Value chain and market resilience: there is an upward pull for companies to address the social and environmental issues which intersect with their business as they are rewarded by stakeholder prosperity and new growth opportunities.

How is it used and how is this evolving?

The rise in interest in outcomes measurement has been consistent across organisation types including businesses, not-for-profits, donors and development aid agencies, a wide spectrum of investors, government, and social enterprises, to name a few.

The growing language around “purpose” and “shared value” and the convergence of global reporting standards and frameworks supporting organisations as they evolve from one dimensional financial reporting to including other forms of capital and value, are significant trends driving the uptake of outcomes measurement. In addition to the need for organisations to be accountable for their outcomes and impacts, recent versatile and bespoke models are gaining ground and are steadily fuelled by their use as a basis to value a previously unvalued set of organisational assets and thereby monetize and design innovative investment models. The combination of the convergence of new organisation models and purpose-led agendas, the maturity of outcomes measurement and the attention of capital markets demanding a wider definition of capital performance calls for a market approach augmented by an outcomes focus.

Community sector organisations and their funders have a growing interest in outcomes measurement. This is leading to more of them implementing (or planning to implement) systematic outcomes measurement frameworks for their organisations and their funding programs. They are also beginning to use the outputs from outcomes measurement to inform strategy development and performance improvement.

For many decades, the international development community has used the principles of outcomes measurement to inform program design, delivery and evaluation. Similarly, governments have also increased their reliance on the outcomes approach to evaluate investments in public spending and investment to ensure greater transparency and returns are achieved.

The biggest shift in the users of outcomes measurement has been in the business community. Capital market driven for-profit enterprises, both large and small, have begun to use the outcomes evaluation techniques and leverage a richer, deeper analysis of value drivers to support better decision-making.

AS OUTCOMES MEASUREMENT FRAMEWORKS HAVE COMMON ELEMENTS, ORGANISATIONS CAN START THEIR JOURNEY NOW

Organisations can start the journey now to trial the most appropriate framework for their organisation and operating context to stay ahead of their competition. In this new era of rapid change, first movers will be at a distinct advantage in shaping the future of outcomes measurement and also building the culture within their organisations to meet the challenges and opportunities that this brings. In reality, organisations are at varying stages of maturity using outcomes measurement to guide decision-making but failing to act now means that organisations not only are at risk, but could be missing opportunities.

An organisation seeking to measure value creation will need to consider the development of an outcomes measurement framework – the framework is an approach to measure a suite of outcomes, beyond just financial capital. The figure below shows the key elements of an outcomes measurement framework.

Figure 15: Outcomes measurement framework

This framework is the approach to measuring a suite of outcomes, beyond just financial capital.

Outcomes measurement framework can be used to:

1. Enhance business strategy by seeking to increase an organisation's total value
2. Assist in design of programs and projects that deliver more for less
3. Provide a broader value based assessment of programs and projects in delivering desired outcomes
4. Support evaluation of social and green bonds

All outcomes measurement framework are underpinned by three key input drivers

Value outcomes universe

The framework draws from a universe of social, environmental and economic inputs and outputs

Measurement techniques

Defined techniques are utilized for measuring outcomes including: modelling, survey, calculation

Financial proxies

Financial proxies are used to value the measured outcomes and are drawn from existing proxies or developed specific to the assessment

WHAT ARE THE BENEFITS?

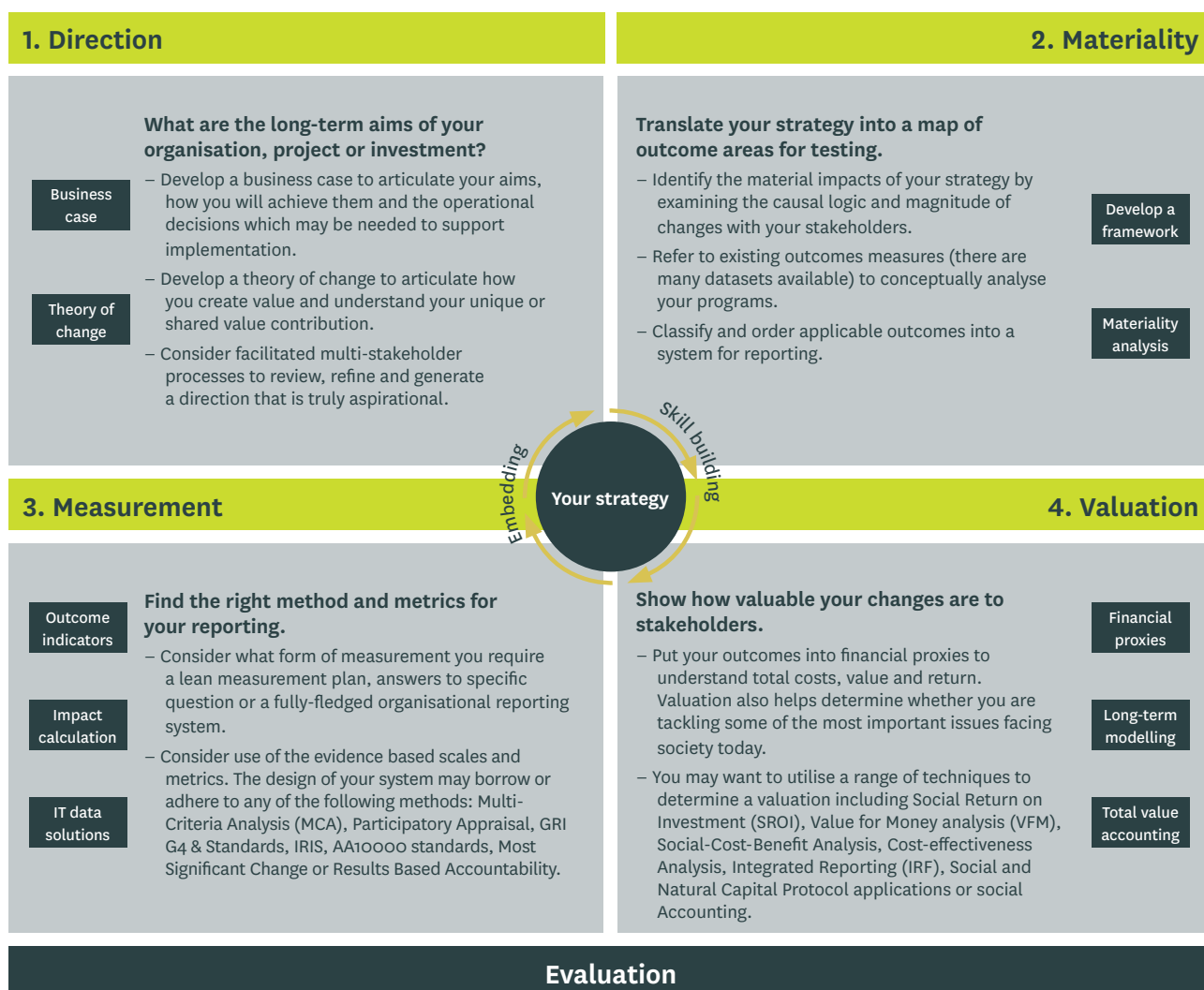
1. Outcomes measurement provides a range of benefits for anyone and everyone involved in investing in social change – as it is primarily a tool to measure and understand progress toward goals. In general, organisations that measure and demonstrate a link between outcomes and community level impacts are of more interest to funders and investors.

1. *It provides the foundation for evaluation, strategic planning and good governance by an organisation.*
2. *Further up the maturity curve, it is critical to improved productivity and good decision-making in respect to the appropriate allocation of resources by funders and providers of capital for an organisation.*
3. *It enables ongoing accountability for organisations, investors and the wider community – whether that is government procuring services of a NFP, individuals choosing to provide philanthropic support, or impact investors seeking attractive investment opportunities.*
4. *It enables the articulation and communication to potential investors and supporters of a 'unique selling proposition' and 'theory of change' to describe the impact that has been achieved and returns generated (financial, social and/or environmental) ... and can be the difference in attracting investment and support in a competitive environment.*
5. *It assists in addressing complex social problems by providing an in depth understanding of the nature and interconnectedness within the system and information about what evidence-based interventions offer solutions.*

How to take the next steps

There are a range of steps that organisations can take to start a journey in impact investment and build their strategy. The diagram below suggests 4 key considerations.

Figure 16: Key considerations in developing an impact investment strategy



EXAMPLE - THE MURRAY-DARLING BASIN BALANCED WATER FUND

The Murray-Darling Basin is one of the world's largest and most productive river basins, accounting for \$19 billion of agricultural output and providing one third of Australia's food supply. However, decades of engineering, over-allocation and the drying effect of climate change have significantly reduced runoff to rivers, creeks and wetlands within the basin.

Figure 17: The Water Fund - financial, environmental and social return



The Murray-Darling Basin Balanced Water Fund (“The Water Fund”) was established in 2015 to provide water security for farming families while protecting culturally significant wetlands that support threatened species. It is the first water investment fund in Australia to allow investors to secure water for agriculture, restore threatened wetlands, and maintain a financial return at the same time.

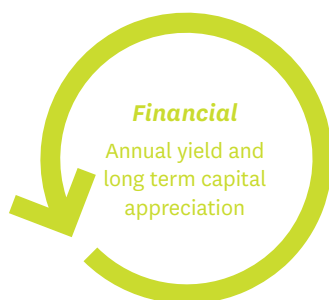
The Fund achieves this by investing in permanent water rights in the southern connected Murray-Darling Basin and seeks to achieve multiple outcomes by reinstating the natural wetting and drying rhythms of the southern Murray-Darling Basin's wetlands and floodplains. When water is scarce and agricultural demand is higher, more water will be made available to irrigation. When water is abundant and agricultural demand is lower, more water will be made available to local wetlands through donations of water and cash to the Environmental Water Trust, which facilitates investment to protect and enhance the environmental health of Australia's natural water resources. It is estimated that over the first 10 years of operation of the Fund, that it will donate approximately 17 gigalitres of water to the Environmental Water Trust for environmental watering purposes.

The table below outlines the Fund's annual watering plan and the three options for water management depending on rainfall conditions.

Figure 18: The Water Fund - options for water management

Option	Rainfall conditions	Flow conditions	Possible targets	Possible volume use and Scenario	Cost
1	Above average 100% Allocation	Flooding	Floodplains, very large wetlands (>200 ha)	Freshes up to 10 GL	Lowest
2	Average to low e.g 100 to 50% allocation	High to Medium	Medium to small wetlands (<200 ha)	3-5 GL pumping with balance in adding to freshes	Medium
3	Very Low <50% Allocation	Low to Very Low & Drought	Small wetlands, drought refugia	3-5 GL pumping	Medium - Highest dependent on allocation

Returns



The fund returns since inception (after fees) are 2.3% Net Operating Profit and Distributions.

The target returns are 7-9% per annum.

Base Case Return objective - Capital growth 5-7% p.a/Net income 2% p.a.



The first watering program by the Fund commenced on 4 April 2016 on Tar-ru Traditional Lands approximately 45km west of Wentworth in south-western New South Wales. Commonwealth water totalling 950 megalitres flowed back into wetlands in the region. The water benefited the environment and a range of wildlife including fish and waterbirds in particular.



The Fund aims to provide meaningful employment and engagement opportunities for the Traditional Owners of the targeted wetlands.

It also supports irrigation communities within the Southern Murray-Darling Basin by ensuring irrigator access to the majority of the Fund's water portfolio. This provides irrigators with the flexibility to respond to cyclic ebbs and flows in water availability.



State of play in New Zealand and Australia for responsible and impact investing

Both New Zealand and Australia are experiencing strong growth across all responsible investing areas including impact investing, albeit from a low base in some categories. The recently published (*Responsible Investment Benchmark Report 2017*) for New Zealand and also for Australia by the Responsible Investment Association Australasia (RIAA) each showed large increases, particularly in screened investments (negative, positive or norms-based). The biggest growth came in screened investments in New Zealand due to the inclusion of assets from eight of the largest KiwiSaver providers who implemented negative screens across tobacco and controversial weapons in late 2016. Growth rates were stronger in New Zealand across all categories of Core responsible investing activity and for the wider, ESG integration based, measure of Broad responsible investing.

Figure 19: Responsible investing funds in New Zealand and Australia

	New Zealand (NZ\$ Billions)			Australia (A\$ Billions)		
	2016	2015	increase (%)	2016	2015	Increase (%)
Impact investing and community finance	\$0.1	\$0.0	–	\$4.1	\$3.7	10%
Screening	\$42.3	\$1.3	3219%	\$33.6	\$24.7	36%
Sustainability themed investing	\$0.4	\$0.3	34%	\$27.2	\$23.1	18%
Core total responsible investing	\$42.7	\$1.6	2649%	\$64.9	\$51.5	26%
Broad responsible investing	\$88.6	\$77.1	15%	\$557.1	\$517.5	8%
Total responsible investing	\$131.3	\$78.7	67%	\$622.0	\$569.0	9%

Source – Responsible Investment Benchmark Report 2017 New Zealand and for Australia

These surveys collected data from asset managers, superannuation funds, financial advisers, banks and community investment managers and so for some smaller and/or more private equity type impact investments, may not capture all individual deals. Highlighting this, the New Zealand survey included its first and only impact/community finance investment in 2016 since it began their separate New Zealand survey in 2013.

For Australia, impact investing and community finance has grown from \$2.1 Billion in 2014 to almost double by 2016 at \$4.1 Billion, according to the RIAA surveys. A separate survey by Impact Investing Australia (IIA), (*Benchmarking Impact*), found 92 impact investments had been made between 2010 and 2015 with 36 of them in 2015 alone and the 15 products covering these investments had a value of \$1.2 Billion in 2015. Green bonds were a large contributor to this total and an additional \$0.8 Billion product entered the market after June 2015. This bottom up analysis did not include some of the broader asset managers covered in the RIAA work, accounting for their larger totals. However, the IIA report did ask the managers, what proportion of assets they would like impact investments to reach in five years. Taking those responses and multiplying by the assets by each of those managers gave a projected demand for impact investments in Australia of A\$18 Billion in 5 years. Interestingly, this compares well with the analysis from the Impact – Australia report in 2013 which calculated a potential A\$32 Billion impact investment market within a longer time frame of 10 years and based on supply potential using the relative size of the nonprofit sector.

Some of the other more significant developments and observations in Australia have come from Government consultations and support for impact investment. The (*Social Impact Investing Discussion Paper*) released in January 2017 by the Australian Government is investigating ways of further developing the market. Recognising both the potential but also that development is at an early-stage, several challenges were highlighted including:

- Investments are generally small scale, bespoke and illiquid
- Due diligence and transaction costs are high for investors and intermediaries
- Few mainstream advisers or wealth managers willing to provide advice
- Often long timeframes involved for social outcomes may not match investor demands

Another example is the encouragement given to utilize philanthropic capital. The fastest growing area of philanthropy in Australia is the private ancillary fund (the equivalent of the US private foundation) where individuals and companies have the ability to make a tax-deductible donations to a charitable trust which then makes annual distributions to eligible charities. However, these trusts also have a pool of investable capital (currently estimated at around A\$10 Billion after commencing in 2001). The most recent changes to legislation for these trusts have included specific guidance about impact investment opportunities such as below market rate loans, providing guarantees and the value of allowing charities the use of trust assets.

The ecosystem in Australia, and more recently being developed in New Zealand, recognises the challenges and the opportunities for impact investments and continues to make progress to enable its full potential to be achieved.

Opportunities for New Zealand and the potential size of the impact market

Recognising that the charity sector is a huge part of the delivery of social and environmental impact in New Zealand and realizing that they have a very large annual income of around \$20 Billion and an even bigger asset base of almost \$60 Billion, points to the already large financial investment in impact. However, seeing the low surplus generated, difficulty in attracting risk or innovation capital and increasing reliance on Government funding, as highlighted in the recent *JBWere New Zealand Cause Report – Shape of the Charity Sector* suggests that the need for other types of investment that produce sustainable (as compared to grant funded) impact will be increasingly needed. How significant could this new opportunity be?

A guide to the potential scale of impact investment in New Zealand can be taken from the current size and growth rates of investment in other countries and adjusting for both their greater level of maturity and the underlying differences in population, economy and charity sector size plus financial markets (as partial funders and investors).

Figure 20: Potential scale of impact investing markets

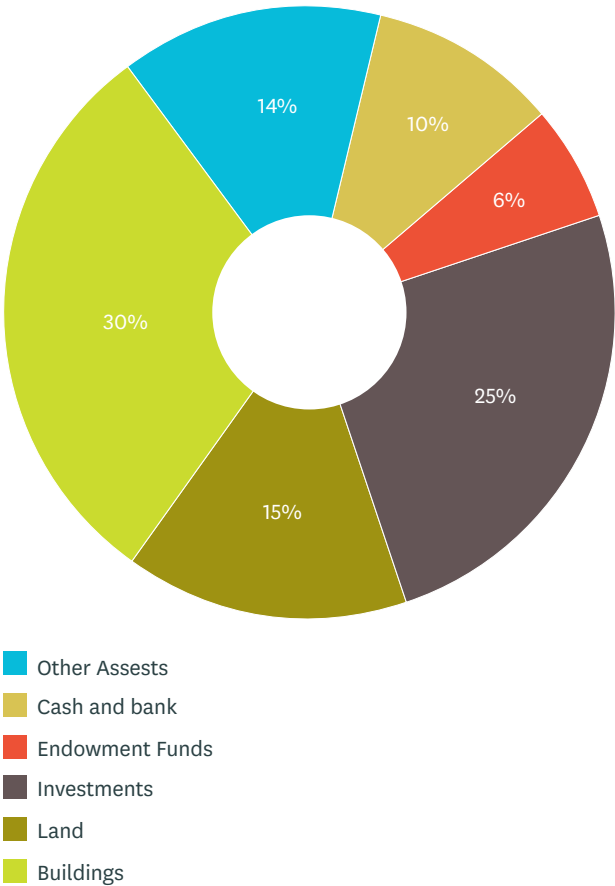
	New Zealand	Australia	United Kingdom	USA
Population (million)	4.6	24	65	324
exchange rate to US\$	1.37	1.25	0.74	1
Charity sector				
Annual income	NZ\$20 B	A\$120 B	£70 B	US\$2,160 B
Assets	NZ\$58 B	A\$220 B	£235 B	US\$4,840 B
Capital markets				
Stocks	US\$70 B	US\$1,140 B	US\$3,270 B	US\$26,000 B
Bonds	US\$80 B	US\$1,910 B	US\$5,530 B	US\$38,400 B
Total	US\$150 B	US\$3,050 B	US\$8,800 B	US\$64,400 B
Gross Domestic Product	US\$185 B	US\$1,250 B	US\$2,650 B	US\$18,560 B
Impact investments				
Total capital currently managed	NZ\$0.1 B	A\$4.1 B	£4.8 B	US\$45 B
Total capital managed as % of charity assets	0.2%	1.9%	2.0%	0.9%
Total capital managed as % of capital markets	0.05%	0.11%	0.07%	0.07%
Total capital managed as % of GDP	0.04%	0.26%	0.24%	0.24%
Future capital managed at 1% of capital markets	NZ\$2.1 B	A\$38 B	£65 B	US\$644 B
Future capital managed at 3% of GDP	NZ\$7.6 B	A\$47 B	£59 B	US\$557 B
Sources				
www.register.charities.govt.nz/CharitiesRegister/Search				
http://www.acnc.gov.au/				
The <i>JBWere New Zealand Cause Report</i> - JBWere				
www.visualcapitalist.com/all-of-the-worlds-stock-exchanges-by-size/				
www.bis.org/statistics/c1.pdf				
www.statisticstimes.com/economy/projected-world-gdp-ranking.php				
www.responsibleinvestment.org/resources/Benchmark-report/Australia/				
www.responsibleinvestment.org/resources/benchmark-report/new-zealand/				
Global Impact Investing Network - Annual Investor Survey 2017				
www.bigsocietycapital.com/latest/type/research/size-and-composition-social-investment-uk				
www.monitorinstitute.com/downloads/what-we-think/impact-investing/Impact_Investing.pdf				
JBWere Philanthropic Services				

The data and calculations in the table shows the current position in New Zealand compared to Australia, the United Kingdom and the USA. It examines the current levels of impact investment as measured by RIAA for New Zealand and Australia, Big Society Capital for the United Kingdom (segments A and B where investors had social intent) and the GIIN for the USA. It then compares this to the scale of each countries charity sector, capital markets and their economy. The relatively immature New Zealand impact market is clearly highlighted in each of these measures but particularly against the charity sector and GDP.

While there is great potential for New Zealand to move towards the current impact investment scale of the other countries, the greater opportunity sits with all of the countries in continuing to grow. The current rates of increase globally in impact investments seen in earlier sections of this report highlight that opportunity. In attempting to estimate the scale of a future impact investment market, the Monitor Institute suggested in its report Investing for Social and Environmental Impact that a market equivalent to 1% of capital markets was achievable based on growth rates in individual impact areas and on the increasing interest and scale of screened social investments. We've used this proportion and also compared it against GDP, finding that around 3% of that measure produced a similar scale of impact investment potential in Australia, the United Kingdom and the USA. For New Zealand, the smaller scale of capital markets compared to GDP produces a much wider range of estimates for future impact investments but an average of the two approaches suggests a market of around NZ\$5 Billion is possible.

Considering where early gains could be made, we need look no further than the significant asset base of the charity sector itself including the assets held as philanthropic capital by both statutory, family and individual trusts. Firstly, although the sector is required to produce a lot of impact, it has built up a large asset base over many years. Analysis of the types of assets held, shows an already large exposure to financial and property investments. There may be situations where these assets could either be better employed or repurposed for impact.

Figure 21: Charity sector assets in New Zealand

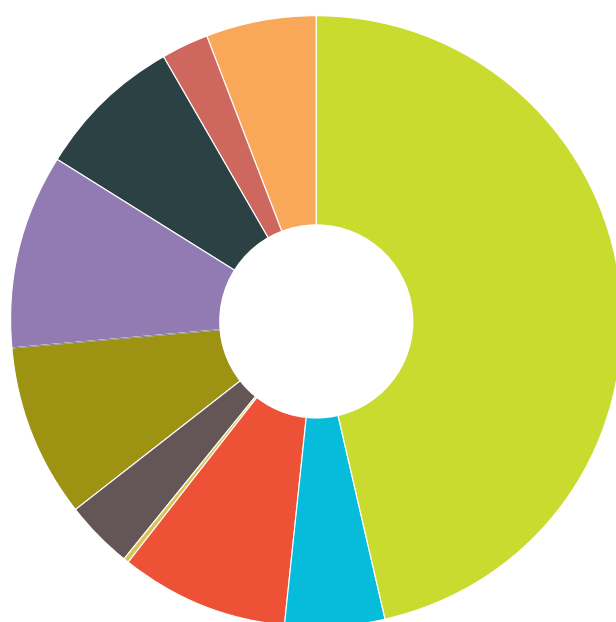


Source – Charities Services, sum of annual charity returns



Within this charity asset base is also a group of grantmaking organisations with significant assets from which they earn income to make annual grants. While good works are achieved with their single digit annual distributions, a much greater impact can be had utilizing the 90% plus of the asset base not being distributed annually. This group are already starting to look towards impact investments and indeed, were some of the initial supporters of the Ākina Foundation itself. Further encouragement for this type of enhanced impact from already dedicated social capital will be welcomed.

Figure 22: Sources of New Zealand Philanthropy



- Personal Donations
- Bequests
- Family and Individual Trusts
- Universities and other Tertiary Inst.
- Community Trusts
- Energy Trusts
- Licensing Trusts
- Gaming Machine Societies
- Lottery Grants Board
- Business and Corporate Giving
- Business and Corporate Sponsorships

Source – Giving New Zealand Philanthropic Funding 2014, Statistics New Zealand

Emerging impact investment activity in New Zealand

The practice of impact investment has existed, if under different names, in New Zealand for some time. Small scale lending, social loans, and financial services have been extended to community enterprises, charitable organisations, and families through a range of specialised services and progressive philanthropic organisations from at least the 1990s. For example, The Nelson Enterprise Loan Trust has made more than 200 loans with the objective of promoting employment opportunities in the Nelson region since 1997, and both Southland Community Trust and the Rātā Foundation have offered lending for community benefit initiatives for a similar period.

However, these services have often run adjacent to mainstream finance and philanthropy, and have largely been unrecognised in policy making. In recent years, two notably successful services, AWHI Credit Union and Prometheus Finance, have both been rendered unviable due to increased regulatory burden and compliance costs.

While these key initiatives have been undermined, there has been, in contrast, a growing awareness of the need for more hybrid financing, and an intent to push for a more formalised and coordinated approach to impact investment. Much of this momentum has been driven by the philanthropic sector, buoyed by key research activities²¹, and amplified by a number of entrepreneurial initiatives in the intermediary space. This movement has latterly received a significant boost through new attention, and some activity, in both the public and private sector.

Importantly, intent on the supply side has been matched by increasing signals of demand. In 2016, Ākina undertook a small-scale 'opt-in' survey to better understand the demand for impact investing from social enterprises within its network. Out of the 109 respondents, key takeaways included:

- 50% of participants were not yet engaging in impact investment, but expressed a desire to see additional funding options
- 25% wanted to engage in impact investing but had no idea where to start – they did not know who provided it or who could support them to access it
- 5% were currently seeking impact investment and were able to service investment but were finding it difficult to find investors who would engage with them
- 10% had raised investment but reported that it had been a difficult and inefficient process. Many noted that the impact side of their business had been viewed by investors as an undesirable distraction from their trading activities
- 10% reported that they had either raised or were seeking impact investment, but were thinking of grant funding

²¹Laura Benedict, 2010; MJ Kaplan, 2013; Di Jennings, 2014; Ākina, 2015.

On a macro-level, increased pressure around issues such as housing, child poverty, and the environment, alongside growth opportunities in enabling sectors such as technology and the Māori economy, have both made the potential, and need, for an expanded impact investment market in New Zealand more tangible and urgent.

ACTIVITY IN THE PUBLIC SECTOR

In early 2017, the New Zealand Government launched its first social impact bond focused on getting South Aucklanders with medium-level mental health conditions back into work. This is a small pilot scheme (\$1.5m invested) compared to the original bond Government sought to issue. However, after the significant controversy following the announcement of the initial proposal (created by a combination of misconception, politicisation, and poor implementation) this represents the continued willingness of the New Zealand Government to find alternative ways of financing social service provision.

More broadly, the public service has been building its capability to work with social service providers on results-based approaches²². These seek to move away from an ingrained focus on the delivery of specific services, and shift the emphasis to the actual outcomes for people. The reality of this shift will require a major transition in culture, capability, business systems, and evidence, and will eventually involve new commissioning models and financing opportunities. If done well, and over time, this will better align the interests and incentives of communities, providers, and commissioners, and unlock greater innovation and accountability in design and delivery of public services.

The New Zealand Government has also been in ongoing conversations with the philanthropic sector to explore the idea of a co-invested social investment fund. The fund is still a high-level concept and further exploration of the idea is on hold while the Government undertakes market research focussed on the need and readiness (for investment) of social impact organisations.

ACTIVITY IN THE PHILANTHROPIC SECTOR

The aforementioned Southland Community Trust and Rātā Foundation both provide good examples of how Community and Energy Trusts, across New Zealand, are increasing their ambition and sophistication in the investment space. The Community Trust of Southland often employs programme related investments (PRIs) that combine grant giving with core investment. Using this blended approach, they recently extended development support and a \$350k interest-free loan to South Alive, a community enterprise, to purchase property. Similarly, the Rātā Foundation has extended a loan to the Stop Trust, a community-based treatment service for sex offenders, to own its first property, from which they provide information, therapy and training. They offered a secured loan of \$500k to be repaid over a 10 year period at the Rātā Foundation's standard interest rate of 3% p.a.

Family foundations, who have more autonomy in their investment decisions, are also innovating. The Tindall Foundation has provided loan finance to the New Zealand Housing Foundation (NZHF) to build new social housing developments. A number of successive loans have been made to NZHF, secured against the property developments. These security interests have then been transferred to the mortgage holder when the property was sold to a householder and the Foundation was repaid. The Tindall Foundation have also worked with Ākina to pilot a 'Readiness Fund'. Modelled on successful initiatives in the UK and Australia, this is a targeted grant fund that seeks to unlock private investment by supporting social impact organisations to prepare for a capital raise, often contributing to the costs of essential professional services or backfilling the organisational capacity.

ACTIVITY IN THE PRIVATE SECTOR

A number of mainstream banks have recently developed partnerships with NFPs to establish initiatives and services in the micro and household finance space.

Kiwibank has partnered with Nga Tangata Microfinance Trust to create the first microfinance initiative in New Zealand. This service provides small, safe and fair loans (of \$2-3k) to households in South Auckland. Loans are directed to responsible, asset-building purposes such as education, family well-being, and essential home goods. Meanwhile, BNZ has committed \$60m of capital to its community finance programme, where it works in partnership with Good Shepherd, the Ministry of Social Development and The Salvation Army to offer fee-free, low-interest, and no-interest loans, to people on low incomes at risk of predatory lenders.

Working at the other end of the commercial spectrum, Westpac made \$100m in new funding available to the CleanTech sector in 2015, with the aim of creating an impact on climate change.

While investment and financial advisory firms are relatively inactive in the impact investment space, increasing interest (and pressure in the case of responsible investment, more broadly) from clients will likely incentivise participation as more reliable investment opportunities come to market. It is also interesting to note that many of the firms in this space are wholly or partially owned by multinationals that have greater confidence and engagement in impact investment overseas.

Angel clubs are an established and essential part of the New Zealand early-stage ecosystem. Though there is no established 'impact' club, there are leaders within Angel groups across the country who are already involved in impact investing. The language and lens of impact is creeping into the mainstream thanks to progressive investors and the values of millennial entrepreneurs (and some from other generations) driving scalable businesses to do good in our world. Angel investment is an intensely personal form of risk taking and the values of our investors are reflected in the businesses that are supported. As the opportunities to invest in impactful businesses increase, so too will the level of participation from Angel clubs and similar structures.

²²Includes the establishment of the Social Investment Agency and programmes such as the 'Acceleration for Results' programme Ākina ran with MSD / MVCOT.

BLENDED ACTIVITY

Beyond traditional sectors, a new generation of specialised impact investment intermediaries and initiatives has recently been established.

Ākina first established its impact investment programme in 2014, initially focused on investment readiness/deal flow development, investor education, and capital raising support. Having brokered seven investment deals, totaling around \$12m of investment, Ākina has partnered with New Ground Capital (NGC) and Impact Ventures to develop 'The Impact Enterprise Fund'. This can be understood as a "finance-first" impact investing fund, focussed on high-growth businesses that are having a measurable social and/or environmental impact. The fund seeks to make market rate financial returns for investors, and is set for its first close at the end of October 2017.

In addition to the partnership with Ākina, NGC is collaborating with the NZ Housing Foundation to launch a Housing Impact Fund in late 2017. This fund will provide capital to acquire housing stock that will then be utilised by NZHF to improve the security of tenure and/or a pathway to home ownership for low-income households via their proven housing programmes. NGC are also developing a Rescue Chopper Fund to finance the upgrade of the country's old and outdated rescue helicopter fleet, and in so doing improve the efficiency and clinic outcomes of this essential public service.

Another early-stage intermediary is Soul Capital, aiming to provide finance alongside support services. Soul Capital is currently exploring its first investments with some seed funding from an Australian partner.

Perhaps one of the most significant developments in New Zealand's impact investment market has been the rise of crowd funding, particularly as it provides a means to bridge challenging early-stage financing needs. Crowd funding has been greatly enabled in New Zealand by regulation that allows platforms to transact equity and debt investments, as well as simply facilitating donations. PledgeMe, one of New Zealand's original crowd funding platforms, purposefully set out to serve social enterprises and community initiatives, alongside mainstream businesses. Since its establishment, it has closed more than 1,100 successful campaigns, raising more than \$15m (around half of which is equity and debt) for a hugely diverse range of projects and early-stage ventures.

Looking ahead, crowd funding platforms stand to play a key role in the financing of community development initiatives, as they provide a low cost and transparent mechanism for communities and loosely formed groups, to organise and raise finance from themselves for themselves. It is worth noting that while more understated, in 2015 community shares initiatives (£96m) in the UK had raised more than six times the capital of social impact bonds (£15m)²³.

COORDINATED ACTION

Beyond individual projects, transactions, service offers, and facilities, there are also a number of strategic and collective activities in train that seek to better coordinate and develop the market as a whole.

In July 2017, the New Zealand Government announced that it would invest \$5.55m in social enterprise sector development through an intermediary/strategic partner. This initiative will include a work programme focused on unlocking capital for innovation and growth, and also supporting the development of market infrastructure.

In addition, a number of actors, from across the private, philanthropic, and community sectors, have self-organised to launch two initiatives:

1. The establishment of an 'Impact Investment Network'. Primarily facilitated through a technology platform, this network will:

- a. Provide tools and resources
- b. Promote news and events
- c. Facilitate connections and learning
- d. Create a channel for deal flow and access to investment opportunities
- e. Oversee the development of the terms of reference that will lead to the establishment of the New Zealand Advisory Board (NZAB).

2. The establishment of a NZAB that will:

- a. Convene a representative, credible, and informed market leadership and governance group
- b. Provide a vehicle to engage with the Global Steering Group process
- c. Consider, research, and recommend actions that relate to the development of market strategy, infrastructure, and regulation
- d. Engage with government and key market building entities such as the Impact Investment Forum to support implementation
- e. Engage with the financial sector and institutional investors to build awareness and confidence in impact investment.

Both of these initiatives launched at the Social Enterprise World Forum held in Christchurch in September 2017.

²³Social Investment Insights Series, Big Society Capital, 2015

Where to from here? Growing a thriving impact investment market in New Zealand

While it is difficult to determine how impact investment will develop in New Zealand, it is possible to identify some of the trends that will influence the breadth of the market's scope and its expansion, and also articulate some of the grounding strategies that should be put in place to ensure that the market performs effectively as it increases in scale and sophistication.

TRENDS THAT WILL DRIVE IMPACT INVESTMENT

As this report has lain out, we are in a time of transition, where social, technological, economic, and environmental drivers position the emergence of impact investment as an inevitability rather than a niche market or passing fad.

Looking ahead, a variety of trends at the global, national, and local level will continue to warrant that social and environmental outcomes be considered alongside financial returns. Ultimately, we are moving into a new economic paradigm where we will be incentivised, and required, to reflect the real value that is created, or destroyed, through all transactions.

Figure 23: Trends driving impact investment

Political	Social	Economic	Technology	Sustainability
Devolution of Power Legislative and policy decisions will open up future market opportunities in early learning and childcare, health and social care, land ownership, transport, and more. New models of financing and appraising performance of these services will arise.	Demographic Change An ageing and changing population is placing increasing pressures on services. Innovation, creativity and collaboration will be required to meet their needs and will require financing aligned to long-term trends and broader social goals.	An Inclusive & Balanced Economy The continuing, long-term priority of achieving a more inclusive economy is driving a broader and more diverse business base. This implies a growing need to foster new models of entrepreneurship and enterprise that encourage more diverse forms of business ownership and offer blended returns.	Digital Disruption New technologies will enable greater efficiency, and re-shape how we work and interact. For impact-led organisations with the right capabilities and financial backing, this will enable new and improved ways of organising, delivering services, and reaching communities.	Ethical Consumption A desire to live better, more sustainable lives means consumers will increasingly make ethical choices. This is likely to fuel demand for impact-led enterprises and normalise new expectations in relation to investor and customer requirements.
Future Public Sector The direction of public sector reform is increasingly toward preventative and customer-focused services. Service providers that have the commercial capability to engage with new models of commissioning while ensuring that people are put first will thrive and require values aligned finance.	Persistent Inequalities Long-term and entrenched socio-economic challenges are likely to persist and may grow. Entrepreneurial leadership and innovation from across society, and within communities, will be necessary if we are to see transformative change.	Business with Purpose A growing number of companies are looking to explicitly pursue social and environmental goals, adopt purpose-led strategies and take on hybrid forms. This will enable greater opportunities for trade and mutual benefit among purpose-led businesses and create new demand for aligned capital.	More Connected Social technologies will become ubiquitous, enabling better communication and real-time interactions. This creates opportunities for connection, collaboration, innovation, and support across communities, and unlocks huge potential for social impact.	Circular Economy Financial capital will increasingly seek to fund activities that mitigate the externalisation of costs, and employ regenerative business principles, where positive development cycles preserve natural capital, optimise resource yields, and minimise system risks.
Rangatiratanga The rights of Māori - whānau, hapū, and iwi - to exercise control over the direction of their institutions, communities and development is consistent with the aims of impact investment. Impact investment can enable asset management and service provision to be locally-owned, people powered, holistic in strategy, and enterprising in nature.	The Influence of Young People A younger generation will bring progressive values and new expectations about society, business and life. These drivers will naturally express themselves through impact driven investments and increasingly influence the mainstream.	Scale Through Shared Value In increasingly competitive and uncertain markets, it may be preferable to scale through forming partnerships that manage risk rather than create it. This will include connecting local, national, and international capacities in new ways, and 'co-mingling' investment approaches between private, philanthropic, and public actors to generate both profits and community benefits.	Transparency & Accountability Technology will make it increasingly easy to access information and invite more public scrutiny. In response, organisations will need to demonstrate good governance and measurable social and environmental impacts, and stand up to greater levels of accountability. Non-financial returns will become a value driver.	Global Goals The Sustainable Development Goals (SDGs) are a universal call to action to end poverty, protect the planet and ensure that all people enjoy peace and prosperity. They provide clear guidelines and targets for all countries to adopt. The SDGs will require substantial investment to be achieved.

A ROADMAP TO MARKET DEVELOPMENT

To enable New Zealand's emerging impact investment market to embrace and harness these trends, we need to create the conditions that provide:

- An appropriately governed, regulated, and resourced market infrastructure that removes barriers to participation while recognising and safeguarding, equally, the interests of all actors
- A connected, diversified, competitive, transparent, and innovative marketplace, that can scale, mitigates duplication of effort, and caters for all the specialised needs and applications that are likely to evolve
- A supported, prepared, and deep pipeline of demand-side organisation and projects, creating a volume of higher quality impact investment opportunities.

These conditions can be created through a roadmap strategy with three work programmes.

Figure 24: Roadmap for impact investment market development

Work Programme	Determinants of Success	Intermediate Objectives	Next Steps
INFRASTRUCTURE Objective: remove barriers and provide facilities that make the market work well for all stakeholders	<ul style="list-style-type: none"> – Access global & regional learning and networks – Coherent, shared, & adaptive market development strategy – Good governance & transparency – Provision of 'hard' infrastructure, eg: <ul style="list-style-type: none"> – Wholesale financing – Readiness financing – Enabling regulation & policy – Impact management tools & platforms – Soft infrastructure, eg: <ul style="list-style-type: none"> – Convening spaces, forums, & networks – Relevant research & evidence – Clear and coherent policy advocacy – Accessible & targeted stakeholder education 	<ol style="list-style-type: none"> 1. Establish a New Zealand Advisory Board (NZAB) that can interface with global & regional governance bodies & processes 2. NZAB to facilitate the establishment of market development strategies and governance 3. Establish and/or engage with market building organisations (i.e. Impact Investment Forum or a NZ equivalent of Impact Investment Australia or Big Society Capital) 4. Secure investment and sustainable resourcing for the provision of hard & soft market infrastructure 	<ol style="list-style-type: none"> 1. Interim working group to develop ToR for the establishment of NZAB. ToR to be developed transparently with oversight from market stakeholders (through the Impact Investment Network) 2. Working group and then NZB to work with Australian counterparts throughout establishment process 3. NZAB to set a market development strategy that can provide a clear direction while remaining adaptive to changes in local market conditions and further global developments 4. NZAB applies to formalise participation in Global Steering Group processes
MARKET PLACE Objective: facilitate an efficient and effective market place where supply and demand side actors can find each other and make transactions happen	<ul style="list-style-type: none"> – Supply of financial capital from multiple sources – Visibility & access to deal-flow – Variety of products that are responsive to demand-side requirements & realities – Effective, informed, and values aligned intermediaries – Access to specialised professional services – Cost effective transactions – Enabling capital raising processes that provide upfront clarity on requirements, timeframe, & expectations 	<ol style="list-style-type: none"> 1. Create an Impact Investment Network (IIN) that provides connectivity, resources, & access to investment opportunities 2. Encourage investment in investing – support the establishment of market intermediaries, funds, and facilities 3. Research & respond to demand-side requirements, creating products and processes that enable, and evolve with, the emerging market 	<ol style="list-style-type: none"> 1. Establish a technology platform for IIN with a dedicated coordinator & supported communications function 2. Secure resources for this to be maintained for interim term (until an appropriate long-term host is established or identified) 3. Support initial members to proactively engage with investment opportunities & intermediaries 4. Create, curate, undertake, & publish tools & research that can inform & enable investment activity
BUILD DEAL-FLOW Objective: a deep pipeline of high-quality investment opportunities	<ul style="list-style-type: none"> – Demand-side culture & capability (commercial & impact) – Stability of revenue streams / markets mechanisms – Capacity of demand-side to engage in investment processes – Viability and preparedness of propositions – Diversity of propositions 	<ol style="list-style-type: none"> 1. Facilitate/attract/gather a pipeline of potential investment opportunities (organisations & projects) 2. Invest in targeted capability building & investment readiness support 3. Provide navigation & education resources for organisations seeking to understand & engage investment processes 4. Undertake research on demand side readiness, needs, & requirements, & widely communicate learning to other market stakeholders 	<ol style="list-style-type: none"> 1. Establish a 'Readiness Working Group' within IIN 2. Align with/co-invest in Government's 'Social Enterprise Sector Development' work programme 3. Work with Government to communicate learning and insights from demand side research (currently being undertaken) 4. Establish / expand an impact investment 'Readiness Fund (as per infrastructure objectives)

Concluding remarks

LEARNING FROM OTHERS AND DESIGNING FOR SUCCESS

New Zealand is currently in an invaluable position to learn from the growing pains of more developed markets, avoid missteps, and design for success from the outset.

In concluding this report, we highlight two risks, and challenge stakeholders leading the development of impact investment in New Zealand to repurpose them into opportunities to shape the work as it progresses.

THE DEMAND SIDE AS EQUAL PARTNER AND CUSTOMER OF CAPITAL

There has been a consistent and repeated trend of the supply side of the market, those with capital and power, leading the debate and dictating the terms of market development. This often leaves large numbers of impact organisations on the demand side marginalised, and little better off than they were in conventional markets.²⁴

It goes without saying that protecting the interests of investors is critical to incentivising their participation and the overall success of the market. However, it also needs to be recognised that the overall opportunity to unlock innovation and impact at scale will not be achieved unless the market sees the organisations actually creating this value as equal partners and the customers of capital.

In this respect, the architecture of the overall market needs to be shared to be effective, and designed for the reality of where demand currently is, in order to evolve it to where we eventually want it to be. In practice, this means ensuring that demand side organisations are represented in all activities relating to the design, development, and implementation of governance and strategy.

THE REALITY OF RETURNS AS THE MARKET GROWS

The second risk relates to raising expectations of financial returns in order to gain traction. While non-concessionary returns can and do exist, and many areas requiring impact will also be growth sectors going forward, it needs to be appreciated that the impact market is nascent, and not yet efficient. Also, that many of the organisations seeking capital within the market are themselves operating in marginal conditions, often addressing social needs in conditions characterised by market failure.

This means that market rate returns across the impact investment spectrum are not yet the norm²⁵, and to conceptualise the market as purely additional and ‘non-concessionary’ is only possible if we cut out large swathes of demand that the market was originally set up to serve. Equally, while it may be the pragmatic option to start serving the market where financial returns are strongest, and thereby creating the best chance of raising capital (indeed, Ākina itself has taken this approach), we need to ensure that these efforts are clearly identified in terms of who they serve and who they don’t. We cannot let the cherry pickings of financial returns set expectations of what a broader field of impact investment needs to cover.

In time, the overall market will get more efficient. There will be significant improvements in how intangibles are valued, and also in how the different impact/risk/reward interests of investors can be blended to create ‘win-win-win’ outcomes for multiple parties within investment instruments. As these innovations take shape, successful yet sub-market ventures will increasingly be enabled to move out of the concessional space, and be rewarded for their relative performance and the real value they create.

Until then, we should resist the urge to up-sell the reality of what the current market offers, and not talk-down the scope of what it needs to serve. While the market matures, we should take inspiration from the immediate gains in impact that can be achieved while recycling capital, albeit with more modest returns.

A PIONEERING SPIRIT

Looking ahead, we should reflect on the fact that the first losses and the greatest risks of any endeavour will always accrue to the pioneers, and that the bigger prizes, that everyone benefits from, aren’t possible without their initial leadership.

While we can stand on the shoulders of learning from other countries, and take confidence from their progress, we can’t expect to start off from where they’ve got to without taking some risks of our own. If we want to see more innovation and impact in New Zealand, we need the conditions in place to make it possible, and we need to use our pioneering spirit to make it happen.

²⁴A demand side view of social investment, Social Enterprise UK, 2017

²⁵Marginalized Returns, Bolis and West, Stanford Innovation Review, 2017.

ABOUT ĀKINA

Our name, Ākina, is a Māori word meaning a call for bold action. It also conveys a spirit of watchful and active encouragement, helping others to identify pathways through their challenges. We believe social entrepreneurs and enterprise represent a powerful opportunity to build a new economy that regenerates the environment and creates social foundations for people to thrive.

Ākina provides a range of specialised services that support social enterprises to start-up and succeed, from innovation process to investment strategy. We also work with community, government, business, and philanthropic partners to develop New Zealand's social enterprise sector, and advance strategic thinking around social impact and inclusive economic development.

Contact

info@akina.org.nz

+64 4 384 9676

<http://akina.org.nz/contact/>

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Contact

Christopher.Thorn@au.ey.com

+61 3 9288 8888

<http://www.ey.com/>

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Contact

craig.patrick@jbwere.co.nz

+64 9 365 8918

<http://jbwere.co.nz/>

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