Impact investing: the role and effectiveness of funds

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[special issue of *Réalités Industrielles*, November 2019]

Abstract :
In light of the urgency surrounding issues relating to the climate, pollution, biodiversity and all forms of inequality, finance must also contribute to changing the world. While some players are prepared to go "green" and inject humanism into their rhetoric, products and services, the financial ecosystem needs to make a genuine commitment and provide tangible proof of its implication. At a time when there are more and more resources for measuring the social and environmental impact of investment funds and when investors have ever stronger requirements, it is appropriate to look at the actual contribution of impact investing funds which are striving to provide a response to the major challenges of our times without compromising profitability. In France, solidarity-based funds, that invest all or part of their assets in firms certified for their social purpose, have been supplying proof of their effectiveness for over two decades.

Scope of social impact investing funds

Shifting definitions

The forms of impact investing have undergone substantial changes. At the outset, the market was confined to investments in unlisted structures with high social value added. Now, multiple stakeholders claim to be part of this movement. According to the Global Impact Investing Network (GIIN), a non-profit that is an international benchmark in this field, impact investing is "an exciting and rapidly growing industry powered by investors who are determined to generate social and environmental impact as well as financial returns". In its 2014 report, the French Advisory Committee on Impact Investing defined it as "an investment expressly combining measurable social impact and financial returns, with the latter ranging from almost no yield to profit levels close to those of the market". But, the generally accepted definition of impact investing is that laid down by the Social Impact Investment Taskforce at the G8 Social Impact Investment Forum in London in 2013 that narrowed it down to investments "that intentionally target specific social objectives along with a financial return and measure the achievement of both". The cornerstones of this foundational definition are: intentionality (social impact and purpose are central to the project's goals), commitment (managers supportive of the positive impact to be generated) and measurement (initiatives rolled out and their effects).

The term “impact” is gaining traction in sustainable finance

Sustainable finance is in constant flux and its scope and terminology are ever-changing. Depending on the era and context, it may be referred to as sustainable finance, responsible finance, socially responsible investment (SRI), ESG-Climate finance (environment-social-governance), “engaged” finance, green finance, solidarity-based finance, and so on and so forth. That said, the notion of impact finance is less opaque, especially for private investors who are put off by the sector’s renown complexity and lack of proof, despite the fact that many of them are looking, imperatively, to fund projects with social and/or environmental impact and to gauge the scope of this impact.

Funds *for impact* should not be confused with funds *with impact*

Due to the broadening of the impact investment market which now extends to funds investing in companies listed on the financial markets, it is now hard to differentiate between so-called ESG funds (which, in addition to financial criteria, factor in extra-financial aspects such as the environmental and social strategy and the good corporate governance of the issuers, and strive to gauge their impact) and so-called impact funds. ESG management lends itself to the question “How?” – how does the company act vis-à-vis its stakeholders? – whereas impact management brings up the question “Why?” – what is the company’s goal? In the first case, investment criteria principally relate to the extra-financial performance levels of the company’s processes and its in-house terms and conditions; they are assessed in relation to standards and in terms of risk management. Here, we refer to funds *with impact*. In the second case, the results of selected firms are assessed in relation to specific impact targets and in terms of opportunities and tangible materiality. Here, we refer to funds *for impact*. It is, for instance, a question of measuring and monitoring the social and societal outcomes of portfolio holdings, such as job creation in vulnerable areas, the contribution to adjusting to climate change or access to health services for underprivileged populations (conversely, the ESG criteria of SRI funds or funds *with impact* concern, in the social arena, aspects such as the assessment of working conditions or gender equality).

90/10 solidarity-based funds in the impact investing landscape

A uniquely French expression of collective management

90/10 solidarity-based funds represent an essential feature of the European impact investing market. Having been given official status by the 2001 Fabius Act, they are bound to invest between 5% and 10% of their assets in unlisted structures accredited as solidarity-based companies with a social purpose (ESUS) or in microfinance institutions not incorporated under French law. The solidarity-based segment can be invested directly in funds or via financing bodies, which are deemed to be solidarity-based, such as specialised professional funds or investment companies. The concept of *social purpose* is crucial: fighting exclusion, supporting vulnerable populations, social cohesion in French regions, international solidarity, and inclusive and citizen-oriented sustainable development and energy transition. The purpose of solidarity-based enterprises (non-profits, NGOs as well as commercial companies) is to create and share value fairly: the objective is *social first*, rather than *finance first.*

Origin of solidarity-based funds

The origins of solidarity-based funds can be traced back by looking at the major milestones of socially responsible investment in France. The 1980s witnessed the first ethically-based collective investments when, in 1983, the *Comité catholique contre la faim et pour le développement* (CCFD), with support from Crédit Coopératif, launched the first "sharing" FCP (mutual fund) called "*Faim et développement*". Part of the income paid out by this fund was earmarked for setting up businesses in the third world. Following the creation of this solidarity-based sharing fund, a solidarity-based investment fund emerged a decade later: the first 90/10 solidarity-based fund, *FCP Insertion-Emplois*, established at the initiative of Caisse des Dépôts et Consignations, Caisses d'Epargne and a trade union (CFDT), which is now managed by Mirova. This fund, which invests up to 90% in French listed companies, is authorised to hold up to 10% in securities of unlisted organisations that create jobs for people experiencing hardship. In the 1990s, the expansion of solidarity-based funds was fostered by financiers and politicians taking a stance against economic exclusion.

The February 1997 publication of a manifesto entitled "Commitment by financiers to foster employment and fight social exclusion" which was drawn up by a group of financiers assembled by Patrick Boulte, bolstered the "Business Declaration against Social Exclusion" that spurred Jacques Delors to call for a similar document to be produced at European level (European Business Declaration against Social Exclusion). Also in 1997, the non-profit Finansol, which arranges for the promotion of solidarity-based savings, introduced certification to distinguish solidarity-based saving products by warranting to investors that they are actually contributing to funding activities that create social and/or environmental value added such as fighting exclusion (first-level social housing, professional integration, etc.), health and social action (taking care of an aging population, reception and care for the disabled or dependent elderly people, early childhood, etc.), ecological considerations (renewable energies, organic farming and short supply chains, etc.), entrepreneurship in developing countries, or popular education and culture.

A high growth market

In recent years, funds relating to sustainable finance have experienced strong growth. This momentum has been essentially driven by demand from institutional investors that have been subject, since 2015, to Article 173 of the Energy Transition and Green Growth Act which requires them to comply with transparency obligations for factoring ESG criteria into their investment policies and concerning the resources rolled out to contribute to the green transition. According to the latest statistics from the 2018 French Social Investment Forum (SIF), out of the €3,500 billion in assets under management in France, almost €1,100 billion are thought to be subject to so-called responsible management and over €300 billion (i.e. almost 10%) to SRI management. Solidarity-based savings, which are the most "engaged" area of sustainable finance, are still a niche segment which is nevertheless highly successful. The market has been continuously growing since the first 90/10 solidarity-based fund was set up. It has been boosted by networks (banks and insurance companies with securities accounts, share savings plans (PEAs) or unit-linked life insurance policies, and solidarity-based employee investment funds (FCPESs)). The regulatory framework (Fabius Act, Fillon Act in 2003, Economic Modernisation Act which took effect in 2010) makes a telling contribution to the success of solidarity-based funds by making it mandatory to offer them in pension and company savings schemes. At the end of 2017, FCPESs stood at €7.4 billion, seven times more than in 2010, and up 20% on the previous year (see "*Zoom sur la finance solidaire*", 2018). At the end of 2018, total outstanding solidarity-based savings represented €12.6 billion, an 8.7% rise over 2017. This was due, in particular, to 423,000 new saver subscriptions via their companies, banks, mutual insurance companies, or directly through a solidarity-based enterprise. Over €9 billion are now invested in 90/10 solidarity-based funds (FCPs and FCPESs), and these funds are managed by Mirova, Amundi, BNP Paribas, or other smaller management companies such as Ecofi Investissements, which invest directly in solidarity-based enterprises or via solidarity-based financing organisations such as France Active Investissement, or specialist investment funds or companies such as Phitrust Partenaires.

Measuring effectiveness

The impact of solidarity-based funds

Solidarity-based fund managers conduct their own analyses and selections and strive to measure the social impact of the companies they choose. They determine tailored and targeted impact data (social housing built and/or managed, hectares of biodiversity protected, number of jobs created or safeguarded, etc.); numbers vary from a dozen to more than one hundred depending on the stakeholder. Social impact is often computed on the basis of reports into the activity of funded structures as a pro-rata of the amount of investments made by the fund, in relation to the amount of permanent capital for all structures.

According to a 2017 study conducted by KPMG, almost 86% of lenders of solidarity-based funds (including asset management firms) consider that impact measurement is useful for improving their financing business and better identifying SSE players with real impact. Next, reporting to external partners allows the relevance of investments made to be justified. Lastly, the rationale of better communication to the general public is in third place. It is estimated that "hybrid" solidarity-based funds and "pure" solidarity-based funds contribute over €1 billion to funding projects with a strong social and/or environmental purpose, essentially through social real estate investment trusts or companies in the agricultural and energy sectors. There is no doubt that they have a social and environmental impact although the targeted amounts remain marginal in respect of regions' requirements, French citizens' savings and the financial resources marshalled for other projects with less impact: 48,000 jobs created or consolidated for people experiencing hardship, 3,050 people rehoused, 22,600 households supplied with renewable electricity and almost 70 economic development stakeholders supported in developing countries (microfinance, agricultural cooperatives, social enterprises, etc.), partly due to the targeting of the financing of these solidarity-based funds (see "*Baromètre de la finance solidaire*", 2019-2020 edition). Finansol estimates that €352 million have been earmarked for social and environmental projects; Impact Invest Lab (iiLab) quantifies these investments at €408 million taking account of all public and private financers of social impact investments by direct and intermediated circuits. Both sources flag up the fact that the majority of these flows originate from solidarity-based funds.

Gauging social purpose

The main goal of all structures with a social purpose is to create social value. It is vital to underscore the fact that performance levels are not limited to financial results and that they should be judged primarily in terms of the social impact generated. This means that assessing this impact helps recognise a different way of doing business. Social impact assessment is geared towards understanding, gauging or leveraging the negative or positive effects generated by an organisation over its stakeholders. The aim is therefore to go beyond the structures' economic actions and activities to understand what the consequences are, and for whom. A partial assessment goal is always determined as it has to be accepted that not everything can be measured, even though these elements are no less interesting. It is often very complicated, or even impossible, to establish compelling evidence of a causal link between an initiative carried out and a change achieved. It is hard to assess all of the numerous factors that are external to the initiative but which could also contribute to this change. Furthermore, assessment is first and foremost a process which is iterative rather than instant. It is also a participative and transparent approach as it involves sharing results with all stakeholders (beneficiaries, volunteers, directors, financers, etc.).

What does the future hold for impact investing funds?

The Business Growth and Transformation Action Plan (PACTE) Act, which makes it mandatory to offer a green, SRI or solidarity-based fund in unit-linked life insurance policies as from 2020, will no doubt foster demand from individual investors for social impact investing funds. Above and beyond the regulatory adjustment, to ensure the continued success of 90/10 solidarity-based funds, these practices will have to extend further than France and become part of a global movement at European level (an approach that would involve European certification) and banking and insurance company networks will have to take up the issue. Education and training are also crucial for explaining to professionals (including network advisers) the importance of the societal challenges and how to offer and present solidarity-based funds to individual customers looking to bestow social and environmental meaning and purpose on their investments.