Investing with Impact

Thrive Africa

AFRICAN ALLIANCE
ASSET MANAGEMENT

TSHIKULULU
SOCIAL INVESTMENTS

Summary

Impact investing, along with ESG (Environment, Social and Governance) focused investing, are not new trends but ones that have garnered increasing interest over the last decade. In this report, we take a look at both impact and ESG investing, discussing their trends, differences and uses. We also highlight the need for impact investing in Africa and how investors can do that without sacrificing financial return.

Finally, we take a look at the partnership between African Alliance Asset Management and Tshikululu Social Investments through Thrive Africa and the solution it provides for investors looking achieve strong financial returns and positive impact.

We find that:

- There are a broad set of challenges facing Africa that need to be addressed.
- Impact investment entails making investments with the deliberate goal of making positive change in a proactive manner.
- ESG investing is primarily a risk mitigation strategy that is incorporated into the investment process.
- Although often grouped under the banner of “sustainable” investing, there are important differences between impact and ESG investing.
- There has been substantial growth in ESG funds in the recent past, but at the same time investors have raised some concerns about the approach.
- Impact investment can help address many of the concerns surrounding ESG.
- African Alliance Asset Management and Tshikululu Social Investments have partnered to proactively drive impact investment in Africa through our Thrive Africa platform.

The challenges facing Africa

Africa is a continent fraught with challenges – high levels of inequality and poverty, low levels of literacy and education, lack of access to basic resources and relatively poor infrastructure, to name a few.

The International Monetary Fund (IMF) succinctly outlines six data points that indicate the challenges faced in Africa[1]:

1. The income gap in African countries, measured by GDP per capita, is growing relative to the rest of the world.

2. We are seeing divergent growth paths across the continent, with non-resource dependant countries faring better.

3. More recently, low access to Covid vaccines and the high cost of getting and administering vaccines will be negative for growth.

4. The Covid pandemic is likely to have lasting effects on the continent as unemployment increases, poverty levels rise, per capita income declines and education is adversely impacted.

5. Debt levels – public and private – have risen, leaving limited room to spend.

6. Unlocking the potential within Africa requires "bold and transformative reforms."

[1] https://www.imf.org/en/News/Articles/2021/04/12/na041521-six-charts-show-the-challenges-faced-by-sub-saharan-africa

An introduction to impact investing

Impact investments are investments made with the intention to generate positive, measurable social and environmental impact alongside financial return[2]. It can be further understood through four key characteristics: Intentionality (investments are made with the explicit intention to generate social and/or environmental impact); Financial Returns (investors deliberately seek financial returns, which range from below market returns to market-related risk-adjusted returns, depending on the investor's objectives); Range (impact investments can be made across asset classes); and Measurement (investors commit to measuring and reporting on the social and/or environmental impact of their investments).

Given the nascent nature of the impact investing industry, there is not yet a global standard in terms of measurement and reporting norms of investments. Significant progress is being made, but the lack of standardisation is a key challenge facing the sector. However, many impact investors – at a minimum – use the United Nations (UN) Sustainable Development Goals (SDG)[3] as a key organising framework.

UN SDGs

Source: www.un.org

Using data from the Global Impact Investing Network (GIIN), we provide some colour on the impact investment market, its players and investment goals.

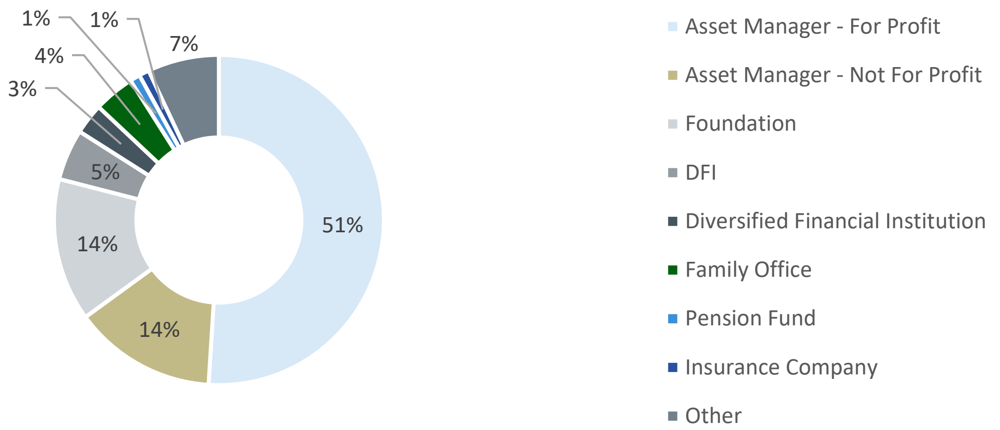
The latest estimate from GIIN is that the size of the impact investing market is USD 715 billion, last measured in 2019. The compound annual growth rate (CAGR) is estimated between 9% and 17% - the figure varies when assessing the growth of AUM of respondents in multiple surveys versus "new" entrants. This also points to the somewhat opaque nature of the impact investment industry and that in reality, if one assumes

[2] As defined by the Global Impact Investing Network.
[3] https://sdgs.un.org/goals

that not all impact investment firms were included in the latest GIIN survey, the size of the market may be much larger.

As part of its annual impact investing global survey (of 294 investors in 2020), asset managers are the biggest players in the impact investment market, making up 65% of the sample.

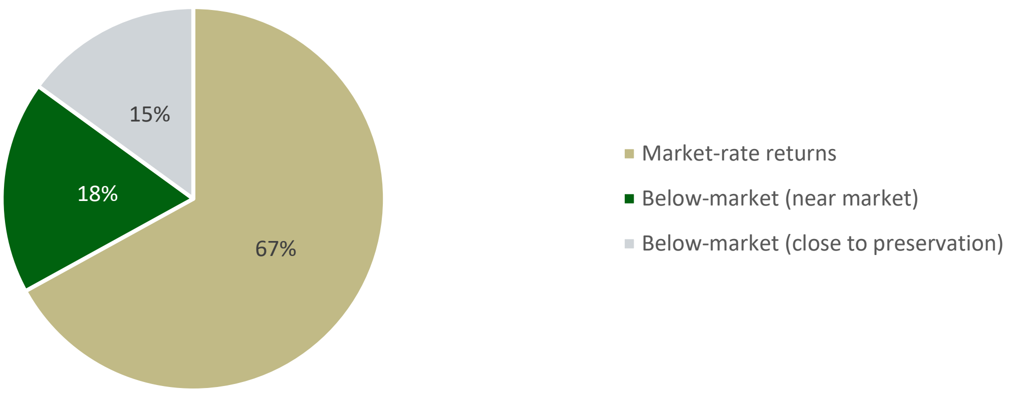
Impact investors by organisation type



Source: GIIN 2020 Annual Impact Investor Survey

While impact investing is sometimes incorrectly understood to be done without financial returns in mind, this is not the case. Every impact investor seeks financial returns, although these returns may vary depending on each investor's specific goals. Most impact investors seek market-rate returns; in other words, they are not willing or able to discount financial performance to drive impact.

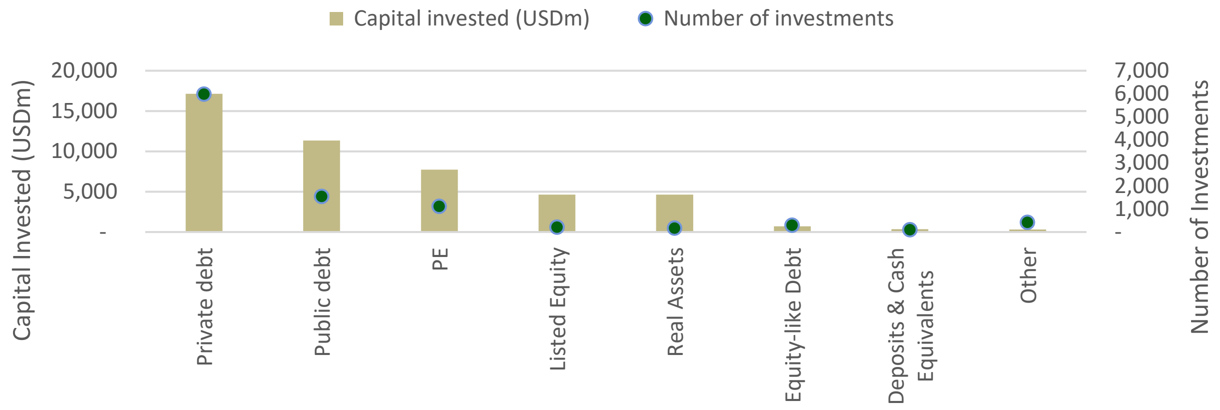
Financial return expectations of impact investors



Source: GIIN 2020 Annual Impact Investor Survey

Unsurprisingly to many, private debt is the asset class that dominates impact investment. However, listed equity has seen the greatest CAGR (33%) between 2015 and 2019.

Capital invested in impact investments across asset classes



Source: GIIN 2020 Annual Impact Investor Survey

In terms of the markets attracting attention from impact investors, the majority of capital (59%) is allocated to emerging markets (EM), with sub-Saharan Africa (SSA) attracting the most assets (21%) within this category. This ties into the need for such investment given the challenges facing the SSA region (as briefly outlined in the previous section).

An introduction to ESG

Environmental, Social and Governance (ESG) investing has grown in vogue with investors over the past decade or so. Investors applying an ESG lens to their work specifically aim to identify the risks and mitigation strategies related to some combination of the following factors.

Environmental

- Climate change
- Pollution & waste management
- Resource depletion
- Greenhouse gas emissions
- Energy
- Water scarcity

Social

- Working conditions
- Human rights
- Conflict
- Health & safety
- Human capital issues
- BBBEE
- Inequality

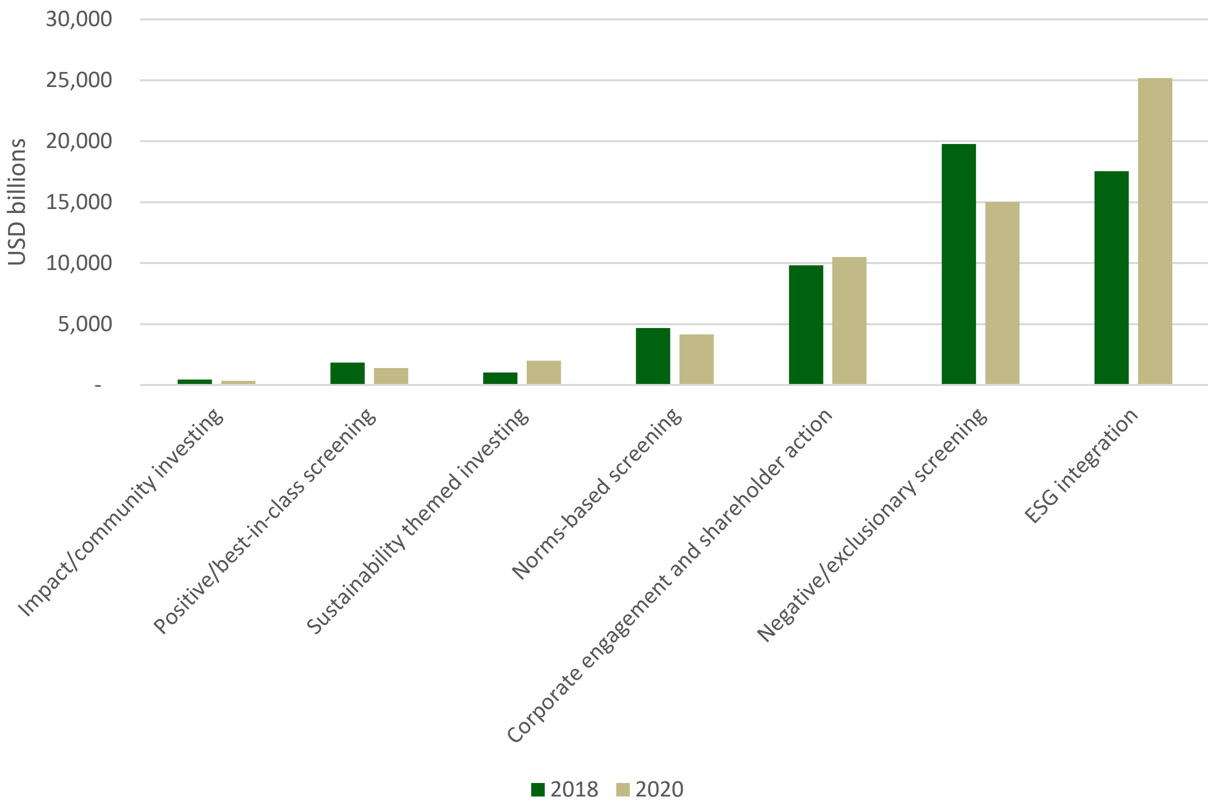
Governance

- Remuneration
- Bribery & corruption
- Political lobbying
- Board diversity & structure
- Tax strategies
- Diversity & independence

The Global Sustainable Investment Alliance (GSIA) surveys[4] the amount of capital invested across investment strategies and shows those integrating ESG to be the greatest relative to other strategies.

[4] 2020 GSIA Global Sustainable Investment Review

Capital allocated to sustainable investment strategies

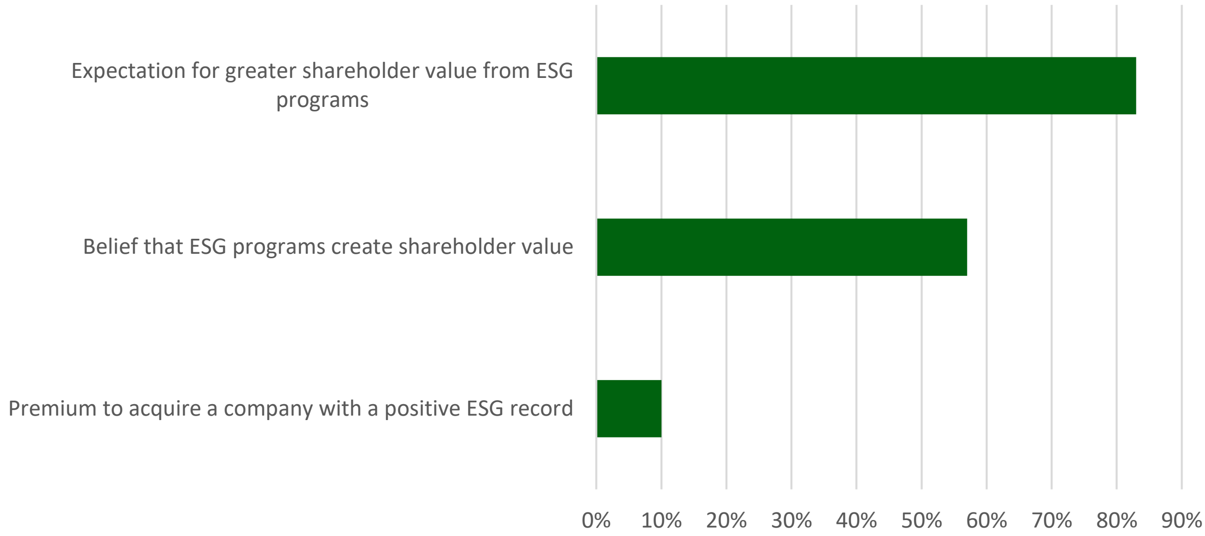


Source: 2020 GSIA Global Sustainable Investment Review

The figures above tie into a report issued by McKinsey & Company[5], where they estimate ESG investing to have reached USD 30 trillion, representing a 10x increase since 2004. Proponents of ESG believe that incorporating these considerations into the investment process enhances returns, given a positive relationship between ESG considerations and a business's long-term success.

[5] *The ESG premium: New perspectives on value and performance* (McKinsey & Company)

Corporate survey on ESG

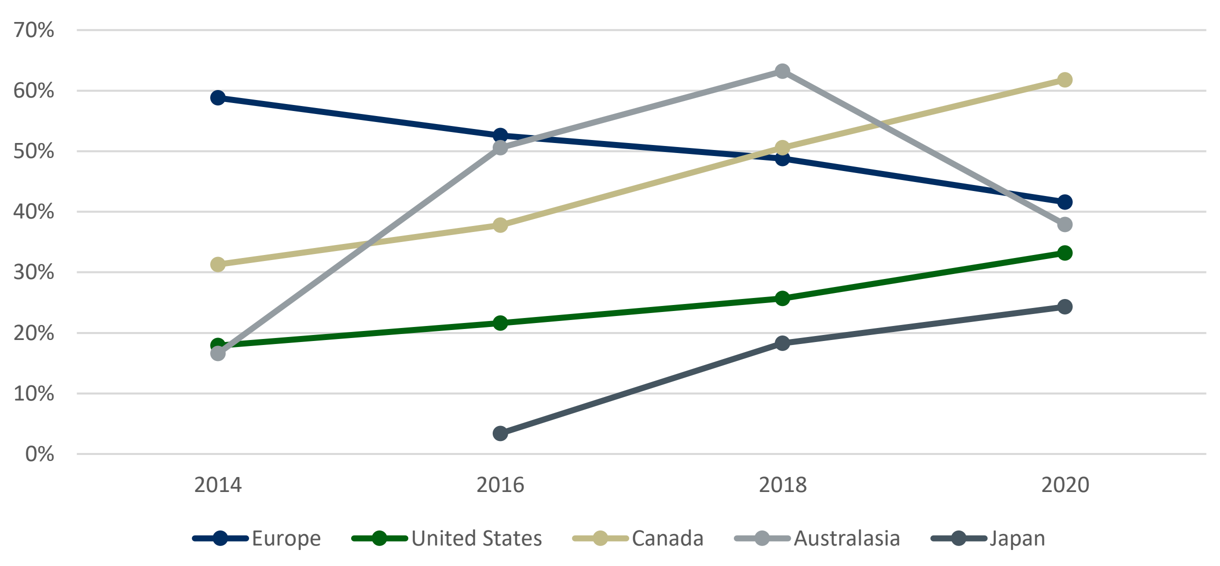


Source: McKinsey & Company, The ESG premium: New perspectives on value and performance

The boom of sustainable investing

In our introductory sections on impact and ESG investing, we illustrated the growth of both over the past two decades. The figures clearly indicate that both have moved to the forefront of investors' minds. The chart below indicates that, in general, there has been growth in "sustainable" investing – this category is defined in many ways but generally includes both impact and ESG – across global markets.

The portion of "sustainable" assets as a % of total assets



Source: 2020 GSIA Global Sustainable Investment Review

It is worth commenting on the decline in sustainable assets in Europe and Australasia as a proportion of total manage assets. In nominal dollar terms, both regions recorded increases in sustainable assets between 2016 and 2020. However, the percentage decline may be attributed to the change in definitions of sustainable investments over the measurement period. In Europe, there has been a "legislative push which now explicitly sets out sustainability standards for sustainable finance products." In Australasia, there has also been a change in the sustainable investment standards, alongside a change in the data source which define the total market size.

It is important to understand the forces driving this trend. We believe that driving factors include:

- Policy and regulation
  Globally we are seeing regulation being put in place that ties in with sustainable investing. This may be in the form of explicit guidelines or future targets but nonetheless it is bringing matters to the forefront.

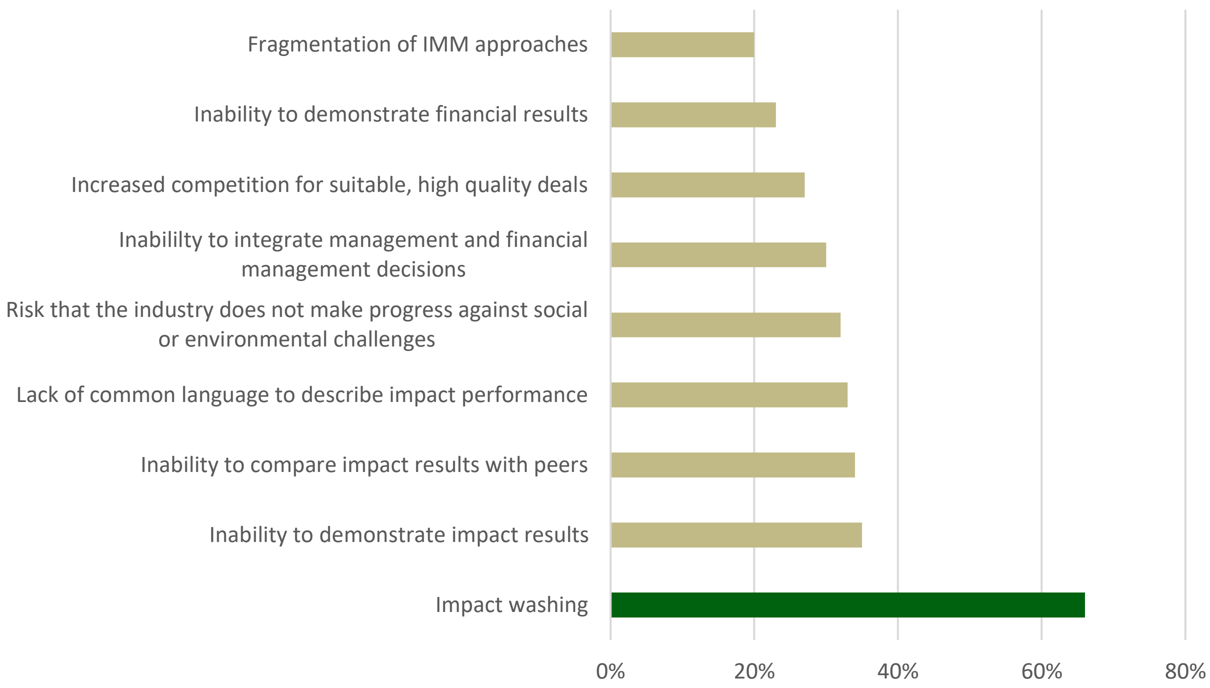
- Market dynamics
  Incorporating ESG into the investment process, whether as a screen or as a factor in asset pricing, has increasingly become a tool used in the investment community.

- Stakeholder demands
  Stakeholders across the board are becoming increasingly aware of the need to include sustainability, in some form, into their considerations.

The growing disillusion of ESG

One only needs to briefly scan the Financial Times or Wall Street Journal to see the latest sceptical or disillusioned opinion related to ESG investing. "Greenwashing" or "impact washing", which essentially is marketing spin on sustainable business and investment practices 'dressed up' as meaningful environmental or social impact, is a growing problem. As more money flows into ESG funds around the world, the potential for abuse of this kind increases as well. This is compounded by the lack of standardised metrics around ESG for effective comparison and performance tracking. This is leading to more and more investors becoming disillusioned with ESG in particular, which can lead to all types of sustainable investing being viewed in a more negative light.

Impact investor's perceived challenges facing the market



Source: GIIN 2020 Annual Impact Investor Survey

Enter impact investment…

The difference between impact and ESG

Across the globe, many lump impact investing and ESG into one category. Although they are related, we believe it is important to understand the differences between the two. In a nutshell, we differentiate impact investing and ESG along the lines of *intent*:

Impact Investing: Seeking to effect change – and measure this change – in a proactive manner when investing funds.

ESG Investing: Primarily a risk mitigation strategy incorporated in the investment process.

In discussing the difference between impact and ESG, we focus on the aspects where impact investing, in our view, improves on ESG, particularly given the development challenges faced in Africa.

	Impact Investing	ESG Investing
Impact Thesis	The most effective impact investors – as well as the impact businesses where they deploy capital – are built around a strong Impact Thesis. This Thesis clearly outlines desired impact, as well as the causal pathways that will lead to such impact (i.e. our investment in this business will lead to a set of pre-determined outputs and outcomes, which will ultimately help us achieve the desired impact).	ESG investors do not use an Impact Thesis to guide their decision-making.
Impact Measurement	Impact investors seek to determine the extent of impact over the life of an investment. In line with the Impact Thesis, impact targets and milestones are laid out alongside financial targets and milestones. Similarly, investee companies are required to regularly report on impact, which forms a key component of overall company (and portfolio) performance. Depending on what the impact data is saying, adjustments to strategy can be made as required, to give the greatest chance of impact targets being met.	ESG measurement is less formalised as part of the investment management process. In particular, the 'S' component of ESG (i.e. Social) usually focuses on 'internal' issues such as working conditions, treatment of staff, etc. While these issues are important, ESG rarely speaks to the impact that an investor and/or business is having for the end-customer/client or community-level.
Financial Returns	As we have highlighted previously, returns are not necessarily sacrificed when making an impact investment. However, some impact investors *may* be willing to take a discount on returns	The consideration of ESG is generally incorporated in order to ensure greater and more sustainable financial returns.

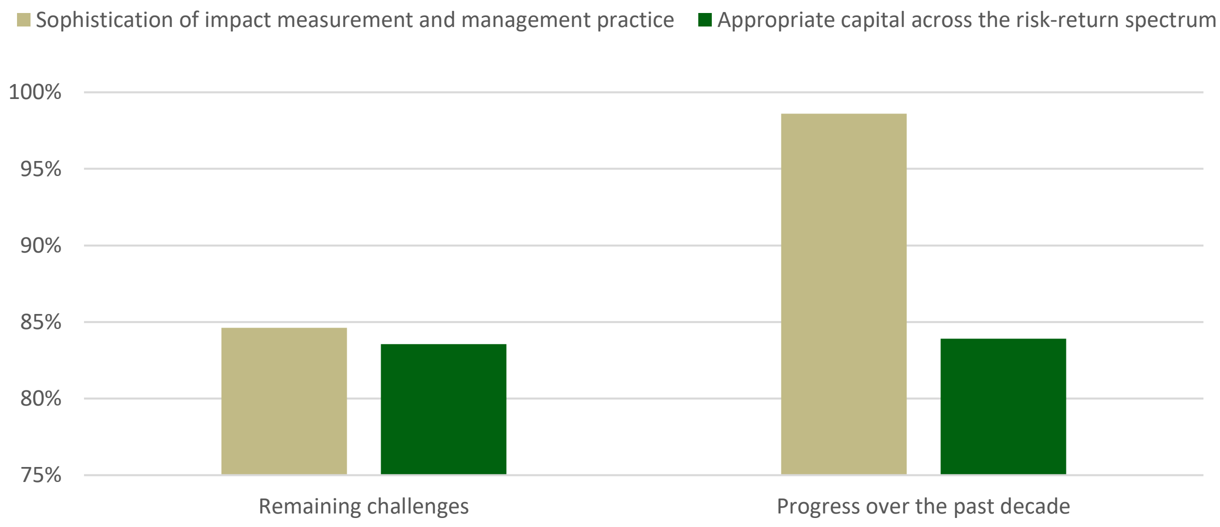
	in order to achieve a higher level of impact.	
Risk Considerations	Impact investors consider risk holistically by assessing it regarding financial returns in conjunction with the risks in achieving (or failing to achieve) the desired impact. Bringing impact risk into the equation is an important change from the ‘traditional’ risk-return assessment made by investors.	As highlighted above, ESG is primarily being used as a screening tool by investors to identify investment opportunities and help to mitigate risk. Some investors have the view that these businesses will be better positioned for long-term returns relative to peers.

The need for impact investing

In other words, our view is that Impact investing, to a strong extent, seeks to build on the foundations of broader ESG investing and irons out the flaws. Perhaps most importantly, the issue of *measurement* is noted. Impact investors deliberately and transparently commit to measuring the impact of their work. To be an effective impact investor, this must go beyond a ‘tick box’ exercise.

Of course, measurement of social impact and change is incredibly complex (and much more difficult than measurement and tracking of financial returns). Much progress in Impact Measurement and Management (IMM, as it is known in the impact investing space) has been made in the recent past, but much work still remains. The GIIN survey cites the “sophistication of impact measurement and management practices” as a larger challenge for impact investors than obtaining appropriate returns.

The portion of “sustainable” assets as a % of total assets



Source: GIIN 2020 Annual Impact Investor Survey

Understanding the impact that an investor is trying to achieve, by outlining an Impact Thesis and implementing a robust IMM process, is a cornerstone of impact investment that sets it apart from ESG.

Impact investing with financial return

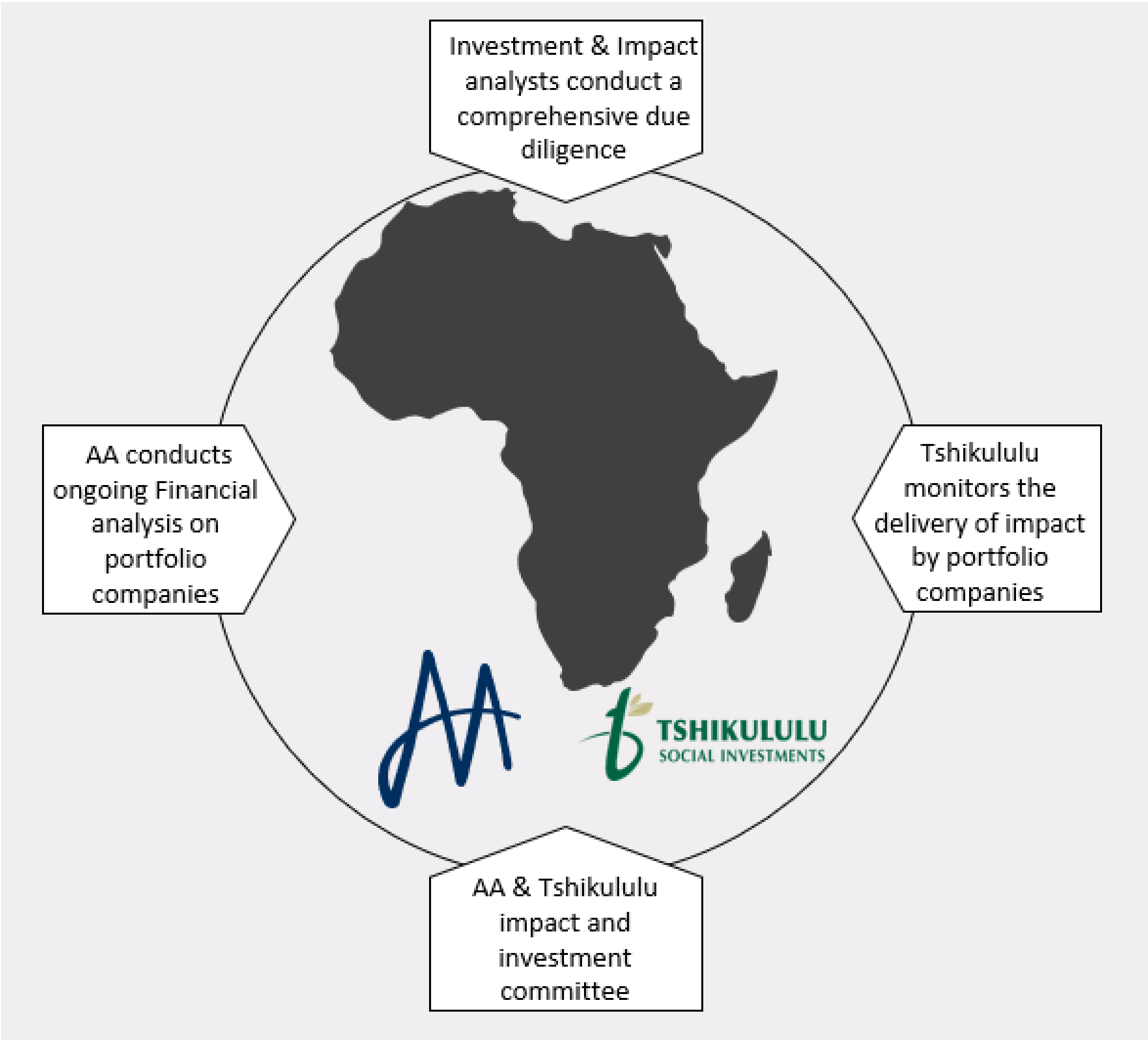
As highlighted in the chart above, generating sufficient returns from impact investment remains one of the key concerns of investors in this space. In addition, there remains stubborn ‘myths’ in the market that investing for impact requires one to sacrifice maximum financial return. Our experience of investing in Africa over the past 20 years has found that one does not need to price in a discount in order to achieve impact goals.

Thrive Africa and the African Alliance Asset Management / Tshikululu Social Investments partnership

The partnership between African Alliance Asset Management and Tshikululu Social Investments – Thrive Africa – is the marriage of sub-Saharan expertise in finance and social impact. Both companies were founded by Africans in Africa. The focus of Thrive Africa will be on delivering sound financial returns and measurable impact.

We have chosen to focus on three specific impact areas: infrastructure, clean energy and financial inclusion. By investing in this space, as outlined in our Impact Thesis, we believe Thrive Africa will help contribute to a greener, more prosperous and inclusive Africa.

Partnership in practice



Contact

Adam Boros
Head of Social Impact, Tshikululu Social Investments

Main: +27 11 544 0300
Direct: +27 11 544 0338
Email: aboros@tshikululu.org.za

8 Hillside Road
Block B Ground Floor
Metropolitan Building
Parktown
2193

Nicholas P. Piquito
Chief Executive Officer, African Alliance Asset Management

Main: +27 11 214 8300
Direct: +27 11 214 8303
Email: piquiton@africanalliance.com

Illovo Edge Office Block
Building 4
9 Harries Road
Illovo
2196

Postnet Suite 78
Private Bag X11
Birnam Park
2015

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