Funding the SDGs: does impact investing need a global marketplace?

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To fulfill the vision of the Sustainable Development Goals (SDGs), innovative finance solutions are being fashioned for adoption by investment actors capable of channeling large financial flows towards socially responsible corporations, social enterprises, public private partnerships and other market led social interventions. But sustained ethical investors' interest in impact investment hinges on credible assurances that the funds invested can and do generate social value. In the brave new world of impact investing, asset managers and service providers should have access to expanded and user friendly market places designed to facilitate deal making and the assembly of tailor-made partnerships that bring together in a cost-effective way social entrepreneurship, development expertise, scaled up delivery systems, in-depth country knowledge - as well as robust evaluation mechanisms.

A new initiative for scaling up innovative finance solutions was launched on October 10, 2016, by the United Nations Secretary General[1]. It is designed to open the gates of private capital markets to socially and environmentally sustainable investment. But ensuring that impact investing will grow and be sustained on the scale needed to fund the Sustainable Development Goals (SDGs)[2] hinges in part on building confidence among ethical investors regarding the effectiveness of social impact investments[3]. It also requires tapping economies of scale to keep transaction costs in check. This points to the need for effective interaction platforms – i.e. marketplaces – between private wealth managers, service providers and development finance intermediaries capable of attesting to the social value of impact investments.

Follow the money

The United Nations Conference on Trade and Development (UNCTAD), estimates that the SDGs will require annual investments of $4-5 trillion. This is $2-3 trillion above current levels[4]. How is the funding gap to be filled? Relative to the overall requirement, official development aid ($132 billion in 2015), while an essential lifeline for the least developed countries, is almost insignificant at the global level[5]. Nor is the volume of official development aid

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[1] http://www.un.org/apps/news/story.asp?NewsID=55262#.WAVy-_l965c.

[2] www.un.org/sustainabledevelopment/sustainable-development-goals

[3] Public trust in the financial sector is now at an all-time low – 27% vs. 49% ten years ago (www.gallup.com/poll/.../americans-confidence-institutions-stays-**low**.aspxGallup)

[4] UNCTAD. 2014. *World Investment Report, 2014: Investing in the SDGs - An Action Plan*, United Nations, New York and Geneva

[5] Its share of gross national incomes will continue to shrink (http://www.cgdev.org/blog/foreign-aid-shrinking-b-stagnating-or-c-growing)

(or social public expenditures more generally) likely to grow rapidly since governments are cash strapped and burdened by debt that is currently worth $60 trillion and is growing unsustainably at a rate of 5% a year (almost twice the rate of global GDP growth)[6].

Charitable contributions are also small compared to SDGs' funding needs[7] .To be sure, philanthropic foundations are promoters and incubators of high risk-high reward social innovations. But such interventions need to be scaled up to help fulfil the SDG promise. Only foreign direct investment and the private capital markets are large enough to meet the funding requirements of the new global goals: the center of gravity of social funding has shifted towards market led social interventions.

Foreign direct investment undertaken by multinational firms amounted to $1.3 trillion in 2014 and the Global Impact Investment Network (GIIN) estimates that professionally managed private assets total $72 trillion, of which about 0.5 percent channeled towards impact investing[8] – about $360 billion. Doubling this level every year for 3-4 years would be enough to solve the SDG funding problem.

Good intentions are not enough

To face the SDG funding challenge, various networks have emerged to bring together asset managers and service providers with a view to share knowledge and develop standards concerning social impact management and measurement[9]. The concepts and mental models underlying their work have been grounded in business management principles rather than development knowledge and experience.

Impact investing has yet to take adequate account of the diverse operating contexts at country and local levels that help shape development outcomes. It has largely focused on professed goals and intentions rather than actual results aligned with beneficiaries' concerns and aspirations. Thus, the guiding principles issued by the International Association for Impact Assessment (IAIA)[10] do not require systematic and independent verification of results on the ground.

[6] www.economist.com/content/global_debt_clock

[7] Total US corporate and foundation giving in 2015 was $75 billion. The Gates Foundation is doing great work but its total endowment is $40 billion – just enough to keep the global poor going for a week.

[8] https://thegiin.org/impact-investing/need-to-know/#s.

[9] For example, the Global Impact Investing Network (GIIN); Social Value International (SVI); the International Association for Impact Assessment (IAIA); the Forum for Sustainable and Responsible Investment (USSFI), the Global Reporting Initiative (GRI), etc.

[10] http://www.iaia.org/uploads/pdf/SIA_Guidance_Document_IAIA.pdf (page 2).

Similarly, GIIN defines impact investments as those directed to companies, organizations, and funds with the intention of generating social and environmental impact alongside a financial return. Equally, use of environmental, social and governance (ESG) criteria in corporate reporting is not systematically and independently evaluated and the ways in which money managers integrate ESG criteria in their valuation of diverse asset classes is not normally disclosed[11].

These approaches lack transparency and contrast with the operating models adopted by development finance institutions following decades of experimentation aimed at improving development effectiveness under the glare of civil society organizations focused on protecting the public interest.

In pursuit of their investment objectives private sector players have sought guidance from management consultants for their learning needs and to pliable auditing firms and rating agencies for their accountability requirements. This is understandable – these service providers speak the same language, share the same ideological predispositions, and have attended the same business schools as wealth managers.

Setting goals and monitoring progress through a battery of indicators has been the standard approach. Social impact assessors have focused data gathering and reporting on the first three stages of the investment cycle: (i) due diligence; (ii) planning; and (iii) implementation. They have sorely neglected the final evaluative stage and relied primarily on self-assessment: it is as if financial reporting did not require a bottom line or validation by independent auditing.

It seems inevitable that investors will gradually come to realize that intentionality – while essential – is not enough. Self-assessment and regular monitoring do not substitute for credible, proven evaluative evidence that quantifies the true value of impact investing *ex post* (as well as in real time).

This is where independent evaluation combined with self-evaluation throughout the investment cycle comes in – a hard won lesson of development finance experience. Adopting an evaluative culture through a *community of practice* that brings together evaluators and impact assessment professionals would contribute to the adaptability of intervention designs while also generating lessons for the future.

In other words and taking a long view, confidence in impact investing will grow and be sustained only if fund managers channel the resources entrusted to them

[11] http://www.ussif.org/files/Publications/UnlockingESGIntegration.pdf

towards socially responsible corporations, social enterprises, public-private partnerships and other market oriented solutions through institutions that have displayed a proven track record in the identification, design and implementation of effective social interventions and are in a position to provide credible evidence about their impact "on the ground".

Tapping economies of scale

Until now, limited interaction between impact investors and major development assistance agencies has taken place. Yet many of them, especially the multilateral development banks, have demonstrated over many years that they have acquired the capacity to identify, appraise and fund major social programs with support from independent evaluation - a key feature of their corporate governance[12]. These institutions routinely invest a substantial share of their operational portfolios in social sectors, target their activities towards underserved markets and adopt robust environmental and social safeguard policies when funding private corporations.

Connecting impact investors with development finance institutions makes eminent sense since these institutions have accumulated vast operational experience and country knowledge as well as expertise in impact evaluation at all stages of the investment cycle. They are committed to generate solutions adapted to local contexts within the diverse domains of the new global goals. However, they have been slow in reaching out to the ethical investing community and, except for climate change interventions[13], they have only begun to focus on the design of innovative financial instruments geared to the diversity of the new global goals.

The International Finance Corporation and the European Bank for Reconstruction and Development, have long been tasked with financing private sector projects in developing countries based on a triple bottom line[14]. They as well as other global and regional development banks are served by evaluation offices that routinely deliver insightful and often uncompromising evaluation reports at project, country and thematic levels. Such reviews attest to the social value of the socially oriented investments that they finance.

Other modes of delivery could also be explored, e.g. for non-revenue producing interventions, the activities of judiciously selected social enterprises or community level organizations could be bulk packaged to attract private

[12] http://iri.hks.harvard.edu/files/iri/files/impact_investing_in_development_finance_dfis.pdf
[13] http://treasury.worldbank.org/cmd/htm/WorldBankGreenBonds.html
[14] The International Finance Corporation of the World Bank Group invests 100% of its finance in the private sector in developing countries, while the European Bank for Reconstruction and Development (EBRD) invest 85% of its finance in private sector operations in Eastern and Southern Europe, Central Asia, Turkey, some countries in the Middle East and in North Africa.

funding in support of subsets of the new global goals – once again with the proviso that independent assessment by experienced evaluators would be carried out for due diligence and reporting.

Maintain investors' trust

The new global goals embrace an extraordinary variety of development objectives. They cannot be achieved effectively without tailor-made diagnosis, judicious identification of partners, expert intervention design, skilled execution, competent management, effective stakeholder feedback, and rigorous evaluation mechanisms.

Harnessing private capital to solve society's problems would be more likely to deliver positive results if it taps efficiently into the vast reservoir of development experience and skills amassed in the international development finance domain. This is because private funding on the scale required to fund the SDGs means that money managers cannot go it alone if they are to channel sufficient resources towards the new global goals while sustaining ethical investors' trust.

Given their tight operating margins they are constrained in retaining the specialized skills and shouldering the costs associated with proper evaluation procedures. To keep transaction costs in check it would make business sense for wealth managers to tap the experience, the analytical capacities and the delivery systems available to development finance agencies.

Scaling up proven social experiments, taking account of available social research findings, and aligning the resulting programs with country priorities in the context of the SDGs is the key to development effectiveness for private funding entities just as it has been for official development assistance. There is no shortcut.

Equally, attesting to the social value of impact activities through independent evaluation is vital for drawing out the hard-won lessons of experience and for providing robust guarantees to investors that ethical investments generate results. Specifically experience in development finance agencies suggests that independent meta-evaluation that uses intervention level evaluations as building blocks is useful and feasible at the country and sector level to illuminate policy directions.

An opening for new financial instruments?

The advent of the SDGs and their recognition as a valid and legitimate framework for goal setting within the impact investing community in conjunction with IRIS could be a turning point[15]. It may presage a rapprochement between social impact assessors on the one hand and experienced development and evaluation practitioners on the other[16].

Achieving such convergence through a global community of practice would greatly enhance the effectiveness of the overall development enterprise. It would facilitate the design and use of a range of new financial products adapted to diverse investor motivations as well disseminate state of the art evaluation methods adapted to impact investing.

For example, ethical investors vitally concerned with results would seek the comfort of accurate social reporting by investing in derivatives labelled *SDG bonds* that would package social interventions funded by the loans and credits of multilateral development banks (MDBs) in clusters consistent with the SDG logic. The SDG investment vehicles would be backed up by the independent system of notation already in place for attesting to the social value of each intervention[17]. For reporting purposes, these ratings would be aggregated and meta-evaluations of each cluster produced on a regular basis by the independent evaluation department of the MDB concerned.

The huge potential for such bonds is illustrated by the successful start of the Climate Bonds Initiative[18] that is poised to market $100 billion worth of bonds in 2016 in support of climate change solutions. Adding grant elements to each SDG bond issue through involvement of charities and foundations would help finance pilot interventions carried out by non-governmental organizations and/or complementary United Nations programs supportive of the subset of global goals targeted by each bond issue. This would imply a commitment by all the organizations concerned to carry out rigorous and independent evaluations of their activities for social reporting purposes.

Towards a global marketplace

The new gamut of financial vehicles should be designed to reflect the demands and return expectations of a far flung and diverse investor population. As part of their marketing strategy, asset managers may opt for targeting the domains of the comprehensive SDG framework aligned with the distinct social investment preferences of their clients. Their varied aspirations regarding financial returns

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[15] file:///C:/Users/Robert/Downloads/iris-sdgcrosswalkandemetrics-160920150015.pdf and https://www.msci.com/msci-acwi-sustainable-impact-index

[16] J. Reisman and V. Olazabal, *Situating the Next Generation of Impact Measurement and Evaluation for Impact Investing,* The Rockefeller Foundation, New York, October 2016

[17] The multilateral development banks have reached agreement about good evaluative rating practices for public as well as private development interventions (https://www.ecgnet.org/document/ecg-big-book-good-practice-standards).

[18] https://www.climatebonds.net/about-us/partners

and their distinct tolerance levels for financial and development risk would be matched with the offerings of selected public goods providers.

Given the complexity of the development architecture, the proliferation of social enterprises and corporations, the comprehensiveness of the SDGs, and the diversity of country and local operating contexts, no single formula exists to relate investors' motivations and interests with the capabilities of social sector organizations and development agencies. This is the fundamental rationale for expanding interconnected marketplaces that would help asset managers relate to development agencies and other organizations capable of channelling funds on a scale commensurate with SDG needs (with emphasis on market led approaches).

Relating asset owners, such as high net worth individuals, corporations, and retail investors on the one hand, with an extraordinary variety of small non-governmental organizations (NGOs) and social entrepreneurs on the other has its place but on its own it will not achieve critical mass. For such wholesaling operations, fulfilling basic evaluation requirements without prohibitive transaction costs would be challenging.

Beyond the traditional conferences and forums sponsored by social investors, new marketplace events would help relate ethical investment demands with effective and up-scaled social intervention programs. To incubate effective partnerships, the marketplaces might be structured around various dimensions of the new global goals such as the 4 Ps: people, planet, peace and prosperity. Such events would be professionally structured and facilitated to provide convenient and cost-effective venues for meaningful interchange, negotiation, and coalition building between asset managers, service providers, and demand-side actors.

To identify appropriate channels for transferring private savings towards achievement of the SDGs, asset managers would have access safe physical spaces supported by appropriate IT platforms. Thus, face to face interaction, dialogue and deal making would be facilitated by offering ready access to wholesaling development assistance agencies and civil society organizations (such as Oxfam) capable of handling large social development programs.

The expanded marketplaces would also cater to evaluation consulting firms capable of estimating independently the social value of funded interventions wherever this service is not embedded within the development entity funded to identify and manage the interventions. The new physical and virtual mechanisms would also help social innovators secure funding from venture social impact investors for pilot projects that are scalable and responsive to

SDG priorities. Web based platforms would complement the face-to-face events.

Conclusions

Three overarching conclusions emerge from this overview. First, funding of development interventions on the scale required by the new global goals hinges on matching ethical investors' concerns and motivations with professionally managed development programs closely aligned with country-based priorities and systematically evaluated at completion. A *community of practice* connecting impact assessment professionals and evaluators would facilitate the transition.

Second, development assistance institutions, especially the multilateral development banks, are well placed to handle large financial flows towards socially and environmentally sustainable uses. They are also equipped to provide credible assurances regarding social and environmental impacts through independent evaluation.

Third, the promise of impact investing can best be fulfilled by expanding market-like platforms designed to connect asset managers and innovative finance solutions with service providers and tailor-made development coalitions equipped with up-scaled delivery capacities and genuinely independent evaluation mechanisms.

These marketplaces would facilitate information exchange and deal making between wealth managers and wholesale service providers wielding innovative financial products and state of the art evaluation instruments within distinct SDG clusters. Such marketplaces would be designed to forge new development partnerships and close the gap that currently divides the impact investing and measurement world, the evaluation community and the global development finance architecture.

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