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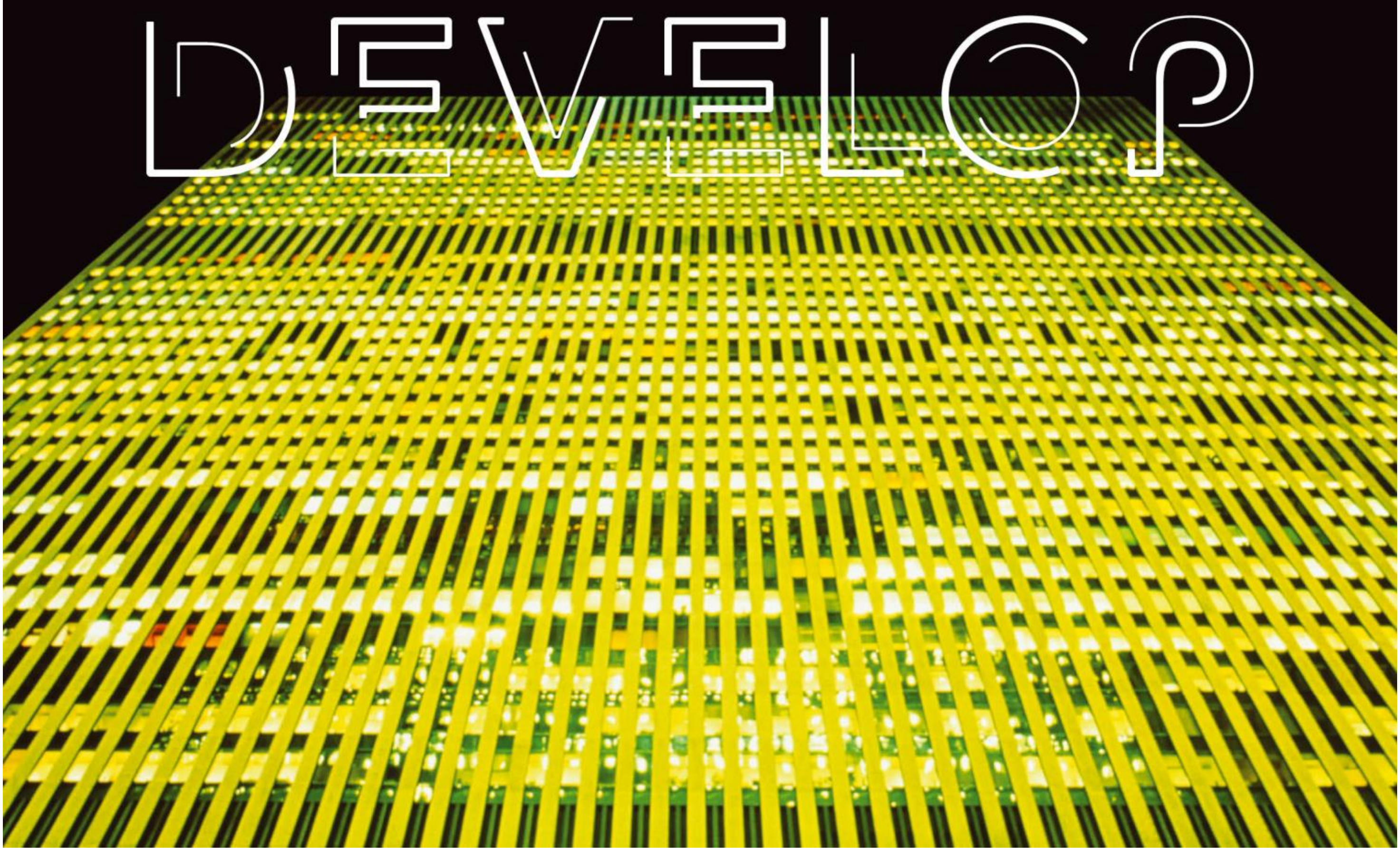
The Impact Investment Market in South and Southeast Asia

Market Snapshot – Impact Investment Funds

February 2017



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Abbreviations and Acronyms

ANDE	Aspen Network of Development Entrepreneurs
AVPN	Asia Venture Philanthropy Network
BoP	Bottom of the Pyramid
DFI	Development Finance Institution
DFID	Department for International Development
ESG	Environmental, Social, and Governance
GIIN	Global Impact Investment Network
GIIRS	Global Impact Investment Rating System
GP	General Partner
HNWI	High Net Worth Individual
IFC	International Finance Corporation
IRIS	Impact Reporting and Investment Standards
IRR	Internal Rate of Return
LMI	Low and Middle Income
LP	Limited Partner
OECD	Organization for Economic Cooperation and Development
OPIC	Overseas Private Investment Corporation
SEA	Southeast Asia
SME	Small and Medium Enterprise
TA	Technical Assistance
WEF	World Economic Forum

Introduction

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1. Introduction

This snapshot presents an overview of the impact investment landscape in selected countries in South and Southeast Asia, specifically Bangladesh, Cambodia, Indonesia, Laos, Myanmar, the Philippines, Sri Lanka, and Vietnam. It is intended to provide an introduction and overview of the different types of impact investment funds active in the region.

Recognising that impact investing encompasses a broad spectrum of investment mandates and vehicles, this report seeks to distinguish funds by distinct categories, and provide insights into the spectrum of financial and impact objectives funds are pursuing in the countries of focus. This segmentation of impact investment funds may help investors, both existing and prospective, identify funds that are best aligned with their unique goals and objectives.

Objectives & Methodology

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2. Objectives & Methodology

2.1 Research Objectives

The objective of this research is to present the impact investment market in selected countries in South and Southeast Asia, specifically Bangladesh, Cambodia, Indonesia, Laos, Myanmar, the Philippines, Sri Lanka, and Vietnam. This snapshot is intended to provide market information to a range of investors and funders.

This report provides information on impact investment fund managers active in the target countries, including: their existing and planned investment activity in the region; their investment strategies; their role in improving access to finance for SMEs; and the profiles of their investors.

2.2 Methodology

Impact Investment Market Scope

In order to analyse the impact investment market, it was first necessary to determine which funds fall within the scope of impact investment. The Global Impact Investment Network (GIIN) defines impact investments as "investment made into companies, organisations, and funds with the intention to generate social and environmental impact alongside a financial return."[1] GIIN further identifies four characteristics of impact investments:

- **Intentionality:** the investor intends to have a positive social or environmental impact
- **Return expectations:** investments are expected to generate a financial return that can range from return of capital to market rate, but are not grants
- **Range of asset classes:** impact investments can be made across a range of asset classes including cash equivalents, fixed income, venture capital, and private equity
- **Impact measurement:** the investor commits to measuring and reporting the social and environmental performance of investments

Using the GIIN definition as the basis, the following parameters were developed to guide what would be considered impact investment funds for the purposes of this research:

- Stated intention to generate positive social and/or environmental impact
- Return expectations ranging from return of capital to risk-adjusted market rate at the fund level

[1] Global Impact investment Network website. https://thegiin.org/impact-investing/need-to-know/#s1 Accessed Aug 30, 2016

- Investments can be made across asset classes, including but not limited to cash equivalents, fixed income, venture capital, and private equity
- The fund measures and reports social and/or environmental impact
- Funds must have personnel or predicted portfolios of > USD $2 million in at least one of the target countries
- Funds focusing primarily on investments that target the microfinance sector were excluded
- Funds are making investments into SMEs

Through the research team's individual networks; industry organisations such as the Aspen Network of Development Entrepreneurs (ANDE) and the Asia Venture Philanthropy Network (AVPN); and investor databases including Toniic and GIIN Impactbase, the research team identified 109 funds (not confirmed to be impact funds at this stage) investing in SMEs in the target geographies. These funds were assessed against the impact criteria developed and funds that did not meet all of the criteria based on secondary research were eliminated. This resulted in a new shortlist of 57 impact investment funds targeted for interviews. After desktop research and fund manager interviews were conducted, 26 funds met all of the required criteria and were selected for profiling. The remaining 31 funds fell out of scope for this research either because they were focused solely on microfinance or because they had no investments made or planned in the target region (although the fund initially planned to invest in Southeast Asia).

Data collection

Based on the location of fund managers and senior investment staff, Cambodia, Indonesia, Philippines, and Vietnam had the largest number of interviewees located in country and were selected as the countries where the research team would travel and conduct in-person interviews. Interviews with fund personnel located outside of these countries were conducted by telephone. No portfolio, investment, or fund review was done in terms of performance. Finally, IRRs referenced in this report have been taken as presented and no analysis or reconciliation between Net and Gross IRRs was conducted.

Results & Analysis

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3. Results & Analysis

3.1 Fund Analysis and Segmentation

The definition of impact investment is broad and models vary across a spectrum. While perfect categorisation is not possible, there are distinct groups (or segments) of funds with different implications for outcomes resulting from a potential investment. This analysis identifies these segments and provides insight into the makeup of the impact investment market in the target countries.

To develop criteria for segmenting the market, funds were first grouped into categories based on overarching investment themes and characteristics. 36 data points were collected for funds and on examination of the data, five variables emerged that were indicative of a high-level fund strategy, while the rest of the data was indicative of specific investment and operational strategies unique to each fund. The following five data points indicative of fund strategies were selected as a basis for segmenting the funds into distinct categories, plus a sixth – investment instruments included for comparative reference.

Geographic focus

- **National** – investing in a single country
- **Regional** – investing in multiple countries within South and Southeast Asia
- **Global** – investing in multiple regions globally

Fund manager experience

- **New** – fund manager raising or managing first fund
- **Experienced** – fund manager has at least one prior fund under management or exited

Impact strategy:

- **Implicit impact** – implicit impact refers to the strategy of investing in frontier and emerging markets to create jobs and grow businesses that adhere to responsible business practices. These funds' core objective is to achieve indicators like: increased numbers of jobs; higher percentage of women in leadership positions; greater adherence to environmental regulations, and taxes paid, etc. These funds support their investees in achieving these objectives, and track and report on impact achieved as well as financial results.
- **Explicit impact** – an explicit impact strategy contains a more specific impact thesis defined by the fund. For example, providing energy access to customers at the bottom of the pyramid; improving the incomes of smallholder farmers; or increasing access to affordable

education. Impact is core to the company's business strategy and metrics related to the explicit impact objectives are measured and reported.

SME stage:

- **Seed stage** – investments made by funds into seed stage SMEs are generally under USD $250,000
- **Early stage** – investments made by funds into early stage SMEs are generally between USD $250,000 - $1 million
- **Growth stage** – investments made by funds into growth stage SMEs are generally over USD $1 million

Target financial returns:

- **Risk-adjusted market rate returns** – represent the level of financial return required by a commercial investor given the risk of a particular investment. Funds vary in their approaches across asset classes and risk tolerance. Impact investments in the region cover both private debt and private equity asset classes and target market rate returns range from 5% to 25% IRR.
- **Concessionary returns** – represent a level of financial return below the risk-adjusted market rate return. Concessionary finance is relative to the geographic market these funds operate across. Generally, funds in the South and Southeast Asia region that seek concessionary returns target below 5% IRR.

Investment instruments

- **Debt/Mezzanine** – funds that invest primarily via debt instruments, mezzanine instruments, or both
- **Equity** – funds that invest primarily via equity instruments

Fig. 3 – Fund Segmentation Matrix

	Geographic Focus			SME Stage			Fund Manager		Impact		Target Returns		Fund Structure	
	National	*Regional*	*Global*	*Seed*	*Early*	*Growth*	*New*	*Experienced*	*Explicit*	*Implicit*	*Concessionary*	*Commercial*	*Debt/ Mezzanine*	*Equity*
	x			x	x		x			x		x	x	x
		x				x		x	x			x		x
			x			x		x	x			x	x	x
	x					x	x			x		x	x	x
	x				x	x		x		x		x		x
		x				x		x		x		x		x
		x				x	x			x		x		x
		x			x	x	x		x			x		x
		x		x	x			x	x			x	x	x
		x		x	x		x		x		x		x	x
			x			x	x		x			x	x	x
		x		x	x		x		x			x	x	x
Funds Profiled			x	x	x		x		x		x		x	x
		x				x		x		x		x	x	x
		x		x	x		x		x		x		x	
			x	x	x		x		x		x		x	x
			x		x	x		x	x			x	x	x
			x	x	x			x	x		x		x	
			x			x		x		x		x		x
	x					x		x	x			x	x	x
	x				x	x		x	x			x		x
			x		x	x		x	x		x		x	x
		x		x	x		x		x			x	x	x
		x			x	x	x		x			x		x
	x				x			x	x		x		x	x
	x			x	x		x		x			x		x

When funds and their attributes were captured in a matrix, three of the five attributes stood out as being the most indicative of fund strategies while two were derivations of one of the other three attributes. The three primary characteristics selected to segment funds were: **impact focus, investment stage,** and **target financial returns**. These three attributes were grouped into four combinations that emerged from the matrix, creating a hypothesis for a segmentation of the impact investment market in the target countries:

1. **Finance First** *(implicit impact, growth stage, market rate returns)*
2. **Balanced Growth** *(explicit impact, growth stage, market-rate returns)*
3. **Balanced Early** *(explicit impact, early/seed stage, market-rate returns)*
4. **Impact First** *(explicit impact, early/seed stage, concessionary returns)*

To test this segmentation, funds were first categorised according to the above combinations of high-level attributes. Each fund fit into a distinct grouping with no funds overlapping across different categories. Next, characteristics of the detailed investment strategies and operational models for each fund category were added and funds were categorised a second time. The resulting groupings were the same as when categorised by the high-level fund strategy characteristics. This confirmed that the four groupings identified were indeed four distinct segments of the impact fund market with corresponding characteristics at multiple levels. As the following descriptions of the four fund segments demonstrate, a potential investment into certain fund segements would have varying impact on developing the market through increasing the availability of capital to SMEs and catalysing additional private sector investment into a fund.

3.2 Market Segments and Fund Characteristics

The following section provides a description of the four fund categories identified and the characteristics and attributes of each.

Fig. 4 – Summary of Fund Categories

	Finance First	**Balanced Growth**	**Balanced Early**	**Impact First**
	Implicit, growth, market rate	*Explicit, early/growth, market rate*	*Explicit, early/seed, market rate*	*Explicit, early/seed, concessionary*
Impact Focus	Economic development, SMEs focused on growing middle class, adherence to ESG standards	Impact on BOP Environmental Impact	Impact on BOP Environmental Impact	Impact on BOP Environmental Impact
Average Ticket Size	$1 million - $15 million	$500,000 - $5 million	$250,000 - $2 million	$10,000 - $1 million
Target Returns (IRR)	12% - 25%	7% - 20%	5% - 15%	< 5%
Fund Size	$25 million - $200 million	$25 million - $100 million	$10 million - $30 million	$2 million - $6.5 million
Geography	Multi-region	Multi-region	Regional and national	Regional and national
Degree of Innovation Supported	- Invest in proven sectors - Fund managers with track record and established reputation	- Invest in proven sectors - Fund managers with some track record	- Invest in more pioneering and new/untested impact theses and sectors - Can be new fund managers	- Invest in the most pioneering and untested impact theses and sectors - Usually new fund managers
Access to Capital	High	Medium	Low	Low
Target SMEs	Growth stage SMEs with track record and validated business model	Growth stage impact focused SMEs with a validated business model	Early stage impact focused SMEs that have limited access to investment capital	Seed stage impact SMEs that have most limited access to investment capital
Ability to Leverage Private Capital	- Sufficiently de-risked to attract private commercial capital - Raise largest amount of private capital	- Sufficiently de-risked to attract private investors seeking impact - Raise largest amount of private capital of the explicit impact funds	- Higher level of risk than Finance First and Balanced Growth funds, too high for many commercial investors - Blended capital used to de-risk funds	- LPs are able to accept concessionary financial return - foundations, philanthropists, etc. - No private commercial investment capital invested in the funds

Finance First: *(implicit impact, growth stage, market rate return)*

Impact Focus	Economic development, job creation, improving responsible business practices. Funds invest in companies with strong environmental, social, and governance (ESG) standards and some specifically adhere to the IFC ESG framework. Funds track and actively work to improve on metrics such as jobs created, proportion of women in leadership positions, number of companies with environmental policies, and number of companies providing employee benefits.
Average Ticket Size	$1 million - $15 million
Fund Size	$25 million - $200 million
Target Returns (IRR)	12% - 25%
Geography	Primarily multi-region
Degree of Innovation Supported	Invest in proven sectors, validated business models and companies with a track record Fund managers tend to have a track record and established reputation
Access to Capital	Funds have relatively high access to capital compared to other fund types. They invest in the most proven business models and established companies compared to other funds in the market and are thus perceived as lowest risk by investors.
Target SMEs	Invest in growth stage SMEs with track record and validated business model. Most are replicating models proven in other regions.
Ability to Leverage Private Capital	The lowest risk of the categories, risk/return profile is generally acceptable to commercial investors. Investors are primarily family offices, HNWIs and DFIs such as KfW, SIFEM, and Norfund.

Finance First funds are characterised by an implicit impact thesis. They create positive impact by nature of investing in frontier and emerging markets but limit investment to companies that adhere to environmental, social, and governance standards. Measuring, generating reports, and actively supporting their investees in improving their environmental, social, and governance standards differentiate these funds from other funds investing in emerging markets. Examples of sectors invested in by Finance First funds are: manufacturing, food and beverage, tourism, healthcare (focused on middle class customers), and education (focused on middle class customers). Examples of metrics tracked by Finance First funds include, but are not limited to: jobs created, proportion of women in leadership positions, number of companies with environmental policies, and number of companies providing employment benefits.

Funds in this category invest in companies that generally have annual revenues of over USD $1 million and employ between 50 -150 staff. Finance First funds are the largest of the four categories and invest in the range of USD $1 million - $15 million per company. Investors in Finance First funds, including Development Finance Institutions, invest for a risk-adjusted market rate return. In comparison to the other categories, Finance First funds have the highest access to capital from private investors as they invest in the most established companies and proven sectors, which investors perceive as the lowest risk.

Finance First funds provide support to their investees through active investment management, for example, providing access to networks and sitting on boards. Some also have a pool of funds allocated to technical assistance, for example Emerging Markets Investment's Cambodia-Laos-Myanmar Development Fund II received USD $500,000 from two of their investors (DFIs), which was allocated to provide grants to investee companies who seek to improve their compliance with social and environmental regulations. Investee companies can access this technical assistance facility for grant funding to cover up to 90% of the cost of regulatory improvements, such as getting environmental certifications or audits.

Finance First fund example: EMI Cambodia-Laos-Myanmar Development Fund (CLMDF II)

Fund manager: Emerging Markets Investment Advisers (EMI). CLMDF II is EMI's second fund. EMI is Singapore based with offices in Cambodia and Myanmar.

Fund Size: USD $64 million (Vintage year 2015)

Investors: Development Finance Institutions exclusively, including Norfund, Swiss Investment Fund for Emerging Markets DEG, the Dutch Good Growth Fund, FMO, BIO, OeEB and IFC.

Investment strategy: CLMDF II invests in promising growth stage SMEs in Cambodia, Laos and Myanmar. The fund typically looks for companies that have revenues over $5 million and meet an "integrity hurdle" and are in compliance with social and environmental regulations. The fund focuses on SMEs serving scalable local markets. Key investment sectors are expected to include: (micro) finance, education, healthcare, food and beverage (including processing), tourism and selected niche manufacturing opportunities. The fund manager will provide technical support in terms of their experience and networks.

Impact thesis: CLMDF II is one of the first private equity funds in its target region. Private equity is another model of financing SMEs in growth stage, often seen as more beneficial to companies with strong growth potential than bank loans that are harder to obtain and require collateral. The fund is contributing to economic development in Cambodia, Laos and Myanmar by supporting transparent and responsible businesses and entrepreneurs who are bringing international management practices, innovation, and strong corporate social responsibility to these markets.

Investment example: CLMDF II is following a similar investment strategy to EMI's CLDF I fund. In 2015 CLDF I made an investment of USD $1 million into Park Café, a restaurant chain in Cambodia, to support the company's regional expansion from 7 locations to 11 in the next year and substantially more by 2020. Park Café operates restaurants offering coffee and casual meals and currently has locations across Phnom Penh.

Balanced Growth: *(explicit impact, early/growth stage, market rate returns)*

Impact Focus	• Impact on BoP (improving access and affordability of essential products and services such as education, healthcare, water, sanitation, and energy, or engaging BoP as suppliers) • Creating employment opportunities where they are most limited • Environmental impact focus • Metrics tracked are specific to sectors of focus; examples include: number of people with access to energy, land degradation avoided, number of people at the BoP accessing affordable healthcare, or increase in incomes to smallholder farmers
Average Ticket Size	$500,000 - $5 million
Fund Size	$25 million - $100 million
Target Returns (IRR)	5% - 20%
Geography	Multi-region
Degree of Innovation Supported	Invest in proven impact theses and business models with demonstrated market traction Fund managers with some track record in sector and established reputation
Access to Capital	Funds have access to capital from private investors but are considered higher risk than Finance First funds
Target SMEs	Invest in growth stage impact focused SMEs with validated business models
Ability to Leverage Private Capital	LPs of these funds are private investors and DFIs that are looking for an explicit impact thesis, generally de-risked sufficiently to provide an acceptable risk/return profile for a private investor seeking market rate returns. Private investors seeking impact investments are willing to commit capital to these funds, although this is currently only a small percentage of investors.

Balanced Growth funds are characterised by an explicit impact thesis, which is core to their investment strategy and defined by clear impact objectives and measurement tools. These funds tend to focus on companies engaging with the bottom of the pyramid (BoP) either as customers or suppliers, or companies focusing on generating positive environmental impact. Models include providing essential products and services such as energy, education, healthcare, sanitation and affordable housing to the BoP, or engaging the BoP in the supply chain, such as agricultural companies sourcing from smallholder farmers. Balanced Growth funds track metrics, which are tailored to the specific impact objectives of the fund's investee companies. Funds primarily draw on the IRIS taxonomy and the GIIRs methodology and adapt these to meet the needs of their chosen impact sector of focus.

Balanced Growth funds invest in SMEs that have validated their models, achieved a degree of growth, and are looking to scale. They make investments that range between USD $500,000 - $5 million per company. Balanced Growth funds provide technical assistance through active management of portfolio companies, providing support in areas such as financial management, HR, and leadership development. They also provide investees with access to networks and may sit on boards. Some funds in this category also have access to external technical assistance facilities. For example, the Aavishkaar Frontier Fund, which is part of a larger fund management company with multiple funds, has a TA facility available to funds within its portfolio.

Balanced Growth funds are smaller than Finance First funds, ranging from USD $15 million - $45 million, and are more likely to focus on one region rather than multiple regions. Balanced Growth funds are perceived to be riskier investments as compared to Finance First funds despite the fact that both Finance First and Balanced Growth funds target market rate returns. Fund managers interviewed believe this is due to investing with an explicit impact thesis being new to most investors, and thus perceived as higher risk.

Balanced Growth fund example: Aavishkaar Frontier Fund

Fund manager: Aavishkaar. The Frontier Fund is Aavishkaar's fifth fund and first fund investing outside of India.

Fund Size: $45 million investor commitments to date

Investors: Primarily DFI's and financial institutions

Investment strategy: Aavishkaar invests in enterprises that engage rural and economically weak populations as producers, users or owners while delivering market rate financial returns. The Frontier Fund currently has one investment each in Indonesia, Sri Lanka and Bangladesh.

Impact thesis: Aavishkaar intends to improve the lives of people at the BoP by investing in frontier markets to help individuals gain better access to essential products/services and income. Aavishkaar will make investments in SMEs whose business models engage in the following: rural supply chains, technology for development, livelihoods, waste management and healthcare.

Investment example: The fund has invested USD $2 million in Cloudwell Limited, a Bangladeshi platform as a service provider in the fin-tech sector, which supports financial inclusion while providing a nation-wide distribution network. Cloudwell's network and technology platform enables retail customers to conduct financial transactions such as mobile talk-time purchase, utility bill payments, mobile banking transactions at local mom-and-pop stores where shop-owners are enabled with Cloudwell's physical/digital point-of-sale (POS) systems.

Challenges faced as an impact fund manager: the biggest challenge for Aavishkaar is attracting additional capital – debt and equity – to the portfolio companies as they scale-up. The fund managers believe there is a strong culture of entrepreneurship in their target countries, and are seeing examples of successful entrepreneurs in these markets, which is attracting talented individuals to undertake enterprises in their target regions.

Balanced Early: *(explicit impact, early/seed stage, market rate returns)*

Impact Focus	• Impact on BoP (improving access and affordability of essential products and services such as education, healthcare, water, sanitation, and energy, or engaging BoP as suppliers) • Creating employment opportunities where they are most limited • Environmental impact - funds track and report metrics related to their specific impact thesis. Metrics from GIIRs or IRIS taxonomies or methodologies developed by the individual fund are commonly used • Metrics are specific to sectors of focus; examples include: access to affordable housing, access to finance for SMEs considered too risky for banks, jobs created for people with barriers to employment, and access to affordable renewable energy
Average Ticket Size	$250,000 - $2 million
Fund Size	$10 million - $30 million
Target Returns (IRR)	5% - 15%
Geography	Regional and national
Degree of Innovation Supported	Invest in more pioneering and new/untested impact theses and sectors Can be new fund managers
Access to Capital	Funds have difficulty fundraising from private investors. Their models are higher risk due to the innovative and sometimes unproven business and impact models of investee companies
Target SMEs	Invest in early stage impact SMEs that have limited access to investment capital
Ability to Leverage Private Capital	LPs are a combination of commercial investors with a requirement for an explicit impact thesis, seek commercial returns but are willing to accept some risk. Many funds have blended capital structures, which they have found useful in balancing the risk/financial return profile and leveraging private capital.

Balanced Early funds are characterised by an explicit impact thesis, which is core to their investment strategy and defined by clear impact objectives and measurement tools. These funds typically require investee companies to track and report on a suite of impact metrics, though due to limited internal resources and capacities, both investors and SMEs often lack the ability to rigorously track and report on impact metrics.

Funds in this category invest in seed and early stage companies in both established and pioneering sectors. Investees in Balanced Early funds are early stage companies without fully validated business models. Their business models could either have been tested in other regions, such as providing affordable housing to bottom of the pyramid customers, or be completely new innovations. Fund sizes range between USD $10 million – $30 million with investments of up to $2 million per company. These funds use an array of financial instruments including venture, debt and equity to meet the needs of investees. Investors in Balanced Early funds are primarily Family Offices and HNWIs, but examples of INGOs and DFIs as investors were also identified.

Balanced Early funds invest in early and seed stage ventures and management is very active providing a variety of technical assistance. This support is more “hands-on” than technical assistance provided by Finance First and Balanced Growth funds. Fund managers stressed the significant amount of non-financial support their early stage investee companies required, including support with impact measurement. All fund managers interviewed in the Balanced Early category said they also support ventures in the pre-investment stage although this is not part of their official mandate but necessary to build a sufficient investment pipeline. This support is provided by fund staff without outside funding, stretching the teams very thin. In addition to supporting portfolio companies, Balanced Early funds may be involved in providing incubation and pre-investment support to help build their pipeline, often without sufficient funding and subsidised by their fund management fees. Although Balanced Early funds provide more non-financial support than Finance First and Balanced Growth funds, they don’t normally have access to external TA funding. This appears to be a factor of the relatively small amount of capital available for Balanced Early funds, and the need to use all capital raised for investment rather than TA. Fund managers echoed the potential for impact by having additional funds to provide the technical assistance needed by their investees.

Balanced Early fund example: Insitor Asia Impact Fund

Fund Manager: Insitor Asset Management. The Asia Impact Fund is Insitor’s second fund.

Fund Size: Target size USD $30 million ($19 million currently committed)

Investors: DFI, family offices, HNWIs

Investment Strategy: By selecting and supporting pioneering companies whose success will spur the creation of new markets and industries, the fund expects to create a multiplier effect on its initial investment. Insitor’s target geographies are: Cambodia, Laos, Myanmar, India, and Pakistan. The fund believes this region presents a unique opportunity to achieve an attractive combination of social and financial returns by seeding high quality social businesses and growing them to a larger scale and demonstrating the viability of business models that also pursue impact objectives.

Impact Thesis: Insitor invests in a new generation of companies that is entering the market to serve the demand of nearly two billion Asians that have limited or no access to clean water, quality food, secure shelters, affordable healthcare, efficient infrastructure, or comprehensive financial services. While the aid community has been focusing on meeting the needs of the most vulnerable segments of the population, a much larger low-income working group has remained under-served.

Investment Example: Khmer Water Supply operates a portfolio of small-scale piped water networks that distribute clean drinking water directly to households in rural Cambodia. Each individual network consists of a centralised filtration system, ground well and water tower for storage, and underground piping that connects to end user households with a water meter. The service provides improved pricing and convenience compared to alternatives such as ceramic filters and chlorination.

Challenges Faced As an Impact Fund Manager: Undeveloped ecosystem for business start-ups. The fund has had to get involved in business incubation and put time into building their pipeline of investments.

Impact First: *(explicit impact, early/seed stage, concessionary returns)*

Impact Focus	• Impact on BoP (improving access and affordability of essential products and services such as education, healthcare, water, sanitation, and energy, or engaging BoP as suppliers) • Creating employment opportunities where they are most limited • Environmental impact • Funds track and report metrics related to their specific impact thesis. Metrics from GIIRS or IRIS taxonomies or methodologies developed by the individual fund are used. • Examples include, but are not limited to, number of people with access to clean water, new market linkages created for smallholder farmers, and number of people with access to sanitation
Average Ticket Size	$20,000 - $1 million
Fund Size	$2 million - $6.5 million
Target Returns (IRR)	Below market rate (generally < 5% IRR)
Geography	Regional and national
Degree of Innovation Supported	Invest in the most pioneering and untested impact theses and sectors Usually new fund managers
Access to Capital	Funds have the most difficulty of the four categories raising investment from private investors. Their models are the highest risk as they invest in the earliest business stages and new and unproven business and impact models
Target SMEs	Invest in seed stage impact SMEs that have most limited access to investment capital
Ability to Leverage Private Capital	LPs are able to accept concessionary financial return from foundations, philanthropists, etc. No private commercial investment capital invested in the funds but goal of some funds is to validate their investment models and attract private capital at a later stage.

Impact First funds are characterised by an explicit impact thesis and support the most pioneering and untested business models. Funds may also be innovative in how they themselves invest, for example, developing and testing alternatives to the traditional debt, mezzanine, and equity investments. They invest the smallest amounts, as low as $20,000 per investment. Fund sizes are also the smallest, ranging from USD $3 million - $15 million. Fund team members tend to be based in the region and in close proximity to their investees.

Impact First funds invest in SMEs pioneering the most untested approaches focused on BoP and environmental impact, and the financial returns they deliver do not sufficiently compensate for the level of risk. Investors in these funds accept the concessionary returns in exchange for the potential impact trade-off. They are primarily philanthropists, foundations, government, multilateral agencies (such as OPIC and the Inter-American development bank), and other entities with impact as the primary objective.

Similar to Balanced Early, Impact First funds invest in early and seed stage ventures and their management is highly active. Some funds within this category are small and new and thus have limited access to funding for technical assistance, but provide as much as they are able through fund management fees. Funds that are associated with larger (typically non-profit) organisations tend to have access to external funds for TA. In addition to supporting portfolio companies, funds may be involved in providing incubation and pre-investment support to help build their pipeline.

Impact First fund example: Mercy Corps Social Venture Fund (Mercy Corps Development Holdings)

Fund manager: Mercy Corps, a non-profit organisation (USA).

Fund Size: USD $4 million

Investors: Family Foundations, HNWIs, Mercy Corps

Investment strategy: Providing early-stage financing to accelerate the growth of scalable, self-sustaining businesses that improve people's lives in an enduring way. The fund does this by pairing their deep, on-the-ground insight into local customs and markets with a unique blend of capital and targeted business expertise.

Impact thesis: The fund invests in innovative seed and early stage ventures that exist to create impact and improve livelihoods through their core business models. Target sectors include agriculture, financial services, last mile distribution, and youth and female employment. Mercy Corps sees complex global challenges as an invitation: to pioneer paths out of poverty, to forge novel partnerships to create solutions that break through entrenched challenges. They see the traditional grant based model of funding international development as limiting, rarely promoting the flexibility and experimentation required to test new models that could sustainably deliver social benefit to millions of people in the developing world. However, many entrepreneurs fall into the "pioneer gap" and struggle to secure seed capital of between US $100,000 - $500,000 to fuel their initial stage of growth. The fund fills this critical gap in the impact investing market for seed and early-stage social venture startups. Mercy Corps believes that connecting these innovative startup businesses to the Mercy Corps platform will accelerate their growth and impact.

Investment example: Based in Jakarta, Indonesia, Vasham leverages a closed-loop business model to provide Indonesian smallholder farms with the financing, expertise, income security and market linkage they need to achieve significantly better standards of living.

[2]

3.3 State of the Impact Investment Market in South and Southeast Asia

When funds were segmented into categories, several themes and conclusions could be drawn about the nature of the impact investment market in the target geography:

Local funds are developing the investment pipeline

[2] Note: Mercy Corps's fund is a philanthropic fund and contributions to the fund are in the form of donations and no financial returns are paid to contributors to the fund

Finance First funds tend to be managed by foreign fund managers, mostly located outside of Asia. Balanced Growth funds are managed by a combination of managers based in and outside of the region, but even when regionally based, the managers tend to be expatriates with experience from outside of Asia. Impact First and Balanced Early funds tend to be based in the region, some focused on only one or two countries. These funds tend to be managed by local fund managers or expatriate fund managers based full time in the region and with deep relationships with the SME sectors in their focus countries.

Managers of large funds investing globally explained that they cannot have staff in each region and, as such, do not have enough knowledge of the region or enough in-country staff to invest in and support early stage companies. They are able to come in and invest in SMEs that have already proven their viability. Fund managers that invest in early stage SMEs stated that being based in the countries they invest in is critical. The regionally based funds investing in early stage SMEs are critical to building the pipeline of investable companies for the larger funds; however, fund managers investing in the growth stage stated that they would like to see a bigger pipeline being developed by the early stage funds.

The role of concessionary returns

The market analysis found a unique feature of Impact First funds: concessionary returns at a fund level. This is the only fund category that targets financial returns that are below what private investors require based on the risk associated with the investment. Investing in the earliest stage SMEs and most unproven business models is the riskiest. As these funds cannot attract many investors due to their risk/return profile they engage donors, including foundations and governments, who invest but are able to accept concessionary financial returns and higher levels of risk. Of the funds surveyed, several Balanced Early and Balanced Growth funds also engaged donors and philanthropists as investors, but in combination with investors seeking market rate returns. In this model, concessionary investors took on more of the financial risk to make it more acceptable to other investors.

The impact investment market in South and Southeast Asia is nascent compared to similar markets in places like the US or UK

Market analysis found that the impact investment market in the target region is relatively new and needs further development. Large global funds invest only a very small proportion of their portfolios in South and Southeast Asia and the fund managers cited challenges finding investable impact SMEs in the region. Fund managers located in the region stressed the nascent nature of SME development and investment and the need for more support to would-be founders of SMEs, including incubation support and mentorship.

Fund distribution across the region

Research identified funds making impact investments in each of the countries researched, but there are notable differences between the SME and impact investment sectors across countries within the region. Indonesia was found to have the most active impact investment industry with the highest number of active funds. Fund managers attribute this to a more developed SME ecosystem and more local investors investing in seed and early stages. Sri Lanka, Laos, and Myanmar have the least investment activity, attributed in part to the underdeveloped ecosystem for SME development. Bangladesh, Indonesia, and the Philippines have the most new funds with planned activity in the region (expanding global funds or establishing new local funds).

Fig. 7 – New vs. experienced fund managers by country

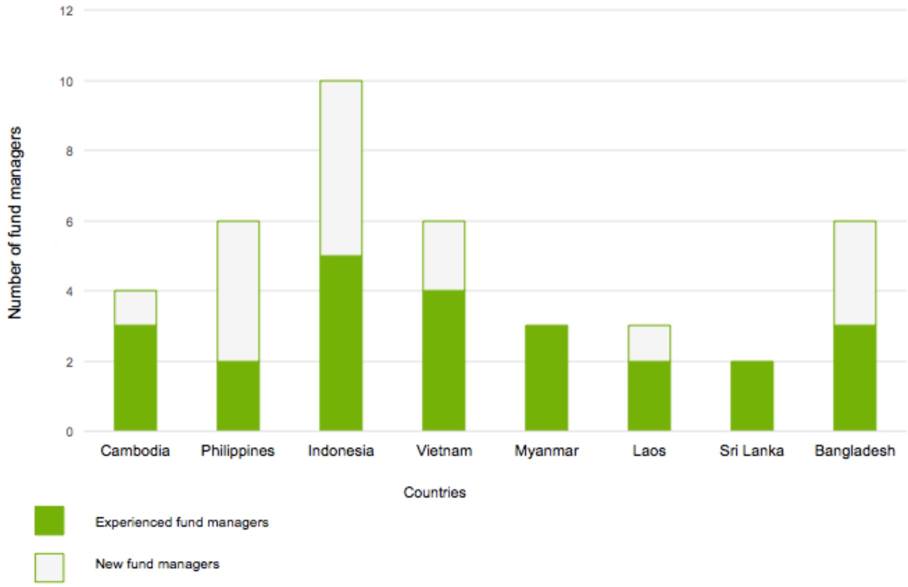
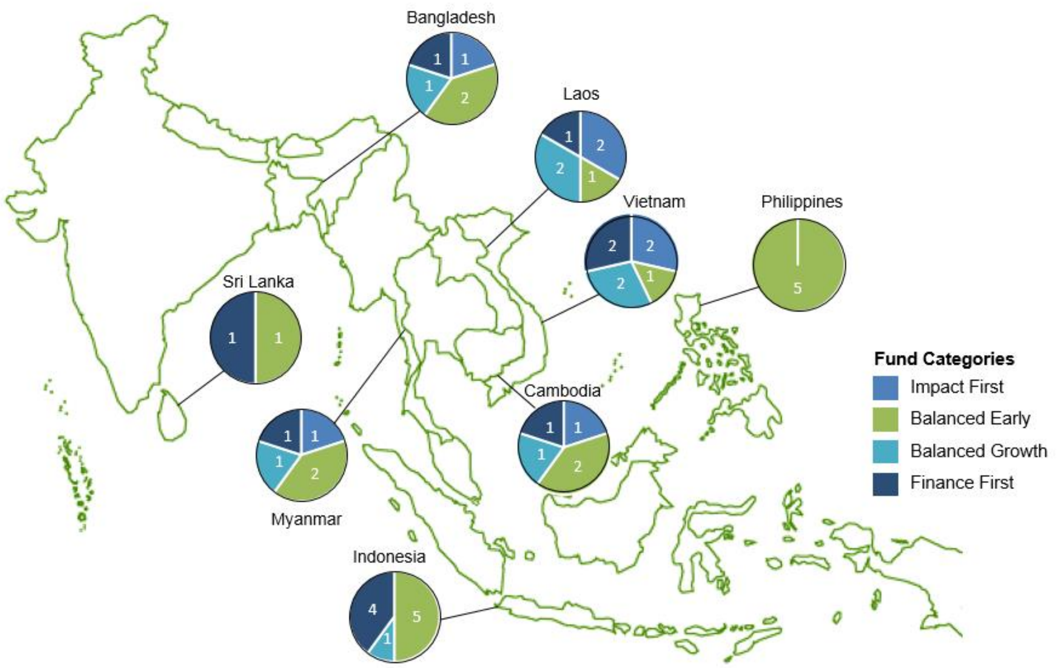


Fig. 8 – Fund distribution by geography



Catalytic Effect

04

4. Catalytic Effect

Impact investment activity has been increasing in recent years but the USD $15.2 billion committed in 2015[3] is still only a small fraction of global asset allocation. While investors surveyed by the Global Impact Investing Network (GIIN) desire to commit more capital to impact investing, they face big challenges:

- Lack of appropriate types of capital across the risk-return spectrum, especially early-stage (including seed and venture) capital that does not necessarily require high returns
- High-quality investment opportunities with track record

In 2015 only 4% of impact investment assets under management globally were allocated to seed/start-up stage ventures and 8% to early stage ventures[4]. 88% of impact investment assets were invested in growth stage and mature companies[5]. This problem is even more pronounced in South and Southeast Asia, which receives only 7% and 6% of global impact investment[6] capital respectively.

Interviews with fund managers resonated with these findings. Although nearly all fund managers stated they desired additional investment in their funds, raising capital was increasingly more difficult moving up the fund categories from Finance First to Impact First funds. While Finance First funds typically raised the target amount for their funds and even achieved over-subscription in some cases, no Balanced Early or Impact First funds experienced over-subscription and most closed their fund at a lower amount than initially targeted, having spent more time than predicted on fundraising. Challenges raising capital from private investors were found to correspond with the SME stage that funds were investing in and how innovative the business and impact models of investee companies were. Earlier stage companies and new business and impact models that have not yet been proven are considered riskier by investors. As a result, Balanced Early and Impact First funds investing in these types of companies have the biggest challenges raising capital.

Fund managers interviewed echoed the desire for investors that were willing to take a higher risk to support the nascent impact investment sector in the region, early stage SMEs, and innovation at the fund and investee company level. Examples of investment that did take this higher level of risk identified through interviews include investment into concessionary Impact First funds and

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[3] GIIN Annual Impact Investor Survey 2016:
https://thegiin.org/assets/2016%20GIIN%20Annual%20Impact%20Investor%20Survey_Web.pdf

[4] Ibid.

[5] Ibid.

[6] Ibid.

investment into Balanced Early funds structured in a way that de-risked the fund for other investors.

Fund managers also stated that they have seen evidence that an investment into their fund by a government related institution has a signalling effect to investors. Fund managers claim that other prospective limited partners view investment by a government-related entity as a “stamp of approval” and signal that the investment opportunity is of high quality. According to fund managers, investment by a Development Finance Institution (DFI) or large foundation would also have this effect and increase the attractiveness and decrease the perceived risk of the investment.

Existing research on the barriers faced by impact investors confirms the finding from interviews. Three pieces of research in particular complement insights collected from fund managers regarding how investment can have a catalytic effect:

- The Blended Finance concept developed by the Redesigning Development Finance Initiative of the World Economic Forum
- Issue Brief on Catalytic First-Loss Capital by the Global Impact Investing Network
- Position paper of the International Development Working Group of the G8 Taskforce for Social Impact Investment Taskforce

The World Economic Forum (WEF) and the Organisations for Economic Development and Cooperation (OEDC) have recognised the role of impact investment in channelling necessary private capital to development goals. In response to barriers preventing private investors from engaging in impact investing, the WEF and OECD have developed the concept of Blended Finance, defined as the strategic use of development finance and philanthropic funds to mobilise private capital flows to emerging and frontier markets[7]. In Blended Finance models, development finance organisations and philanthropic investors blend their funds with those of private investors to address the problems of: returns that are too low relative to the risk level, inefficient markets, and otherwise challenging investment climates[8]. Blended Finance is a means by which a funder not bound by the same requirements for financial returns as commercial investors can de-risk impact investments and catalyse more private capital flow to impact funds facing the biggest challenges to raising investment.

The International Development Working Group of the G8 Social Finance Taskforce makes similar recommendations. The Working Group identified the need for new finance models that encourage better collaboration between public and private sectors and called for the creation of a funds facility that would cultivate and develop new and innovative SMEs and business models to build a pipeline of impact investments. This facility would include grants as well as investment. The Working Group also notes that the traditional DFI model, which includes target sectors such as infrastructure, mining, food processing, and banking, has limited engagement with more innovative impact investment models that explicitly target measurable social returns by investing in companies that

[7] https://www.weforum.org/projects/redesigning-development-finance
[8] http://www3.weforum.org/docs/WEF_Blended_Finance_How_To_Guide.pdf

either target the bottom of the pyramid as consumers or suppliers, or companies pioneering new ways to provide social or environmental impact through innovative business models[9].

The Global Impact Investment Network (GIIN) also explored how to channel more investment to companies that have strong potential for social or environmental impact but are perceived as having too high of a financial risk for commercial investors. Similar to the above-mentioned Blended Finance Models at the fund level, the GIIN recommends the use of Catalytic Credit Enhancement Tools on a direct deal level. Catalytic Credit Enhancement can encourage the flow of capital to impact oriented SMEs by improving their risk-return profiles and making them acceptable to private investors on a direct deal basis[10].

4.2 Supporting SMEs

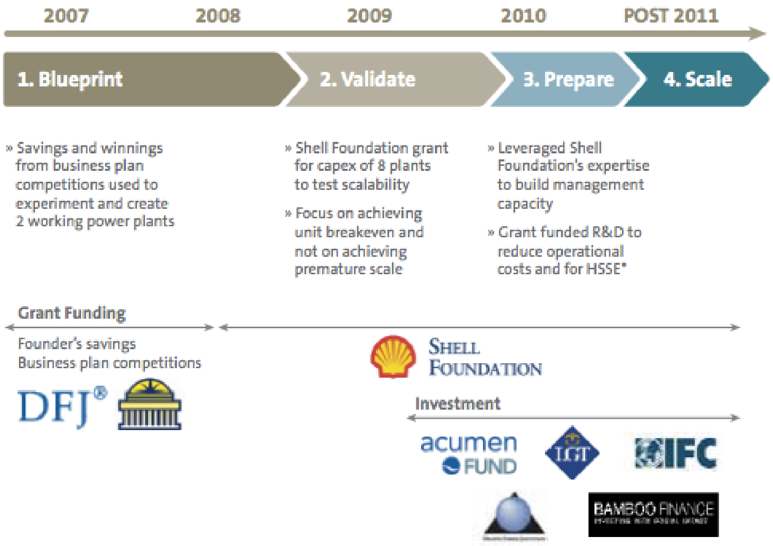
Interviews with fund managers and analysis of the market identified two characteristics of SMEs that face the most difficulty attracting investment capital: the stage of the company and how innovative its model is. SMEs that are both early stage and pioneering the most untested models have the most difficulty raising capital, as do funds focused on these SMEs. The fund analysis found that Finance First funds invest in the most proven models and in the later stages of business growth. Moving down the spectrum, Balanced Growth, Balanced Early and Impact First funds invest in earlier stages and more innovative models. Fund managers of Balanced Early and Impact First funds cited the most difficulty raising capital, as the risk level of the SMEs they invest in is perceived to be too high. In traditional venture capital, investors are willing to take the risks in the early stage and highly innovative models if there is a potential of high financial returns that compensate for this risk. In impact investment, the potential financial return does not often make up for the high level of risk, but the potential impact does. This is where the role of investors willing to take this risk in return for the impact potential comes into play.

Research by Monitor Inclusive Markets found that impact oriented SMEs face a "pioneer gap" — a lack of financing available for innovative business models. To illustrate this concept, the report cites the case of Husk Power Systems, a company that was pioneering a business model for providing low cost renewable energy to bottom of the pyramid customers in India. The case illustrates the stages of funding Husk Power accessed to validate and later scale their model. Grant funding was instrumental in the company's early stages, when the model was in validation stage. In this stage, concessionary impact investors provided funding and when the model was proven and ready to scale, commercial private investor came in with growth capital. Had concessionary investors not supported the model in its validation stage, Husk Power would not have been able to prove that low cost renewable energy could be provided to bottom of the pyramid customers in a profitable way and would not have been able to attract private investors to scale the model[11].

[9] http://www.socialimpactinvestment.org/reports/International%20Development%20WG%20paper%20FINAL.pdf
[10] GIIN Issue Brief: Catalytic First-Loss Capital. October 2013. https://thegiin.org/assets/documents/pub/CatalyticFirstLossCapital.pdf
[11] Koh, Karamchandani, and Katz. From Blueprint to Scale: The case for philanthropy in impact investing. Monitor Inclusive Markets. April 2012.http://acumen.org/content/uploads/2013/03/From-Blueprint-to-Scale-Case-for-Philanthropy-in-Impact-Investing_Full-report.pdf

Fig. 9 - Philanthropic investment and the pioneer gap:

Husk Power Systems case study[12]



More recently the Omidyar Network again highlighted this financing gap in the report "Frontier Capital: Early stage investing for financial returns and impact in emerging markets." The report draws on extensive interviews with field leaders as well as Omidyar Network's 10 years of experience and over USD $850 million invested. It makes a distinction between SMEs operating in emerging markets and those operating in emerging markets while also targeting Low and Middle Income populations (LMI). According to Omidyar Network's findings, SMEs serving LMI populations face a unique set of challenges. Unlike the many SMEs operating in emerging markets that are replicating and adapting business models de-risked and proven elsewhere, SMEs serving LMI populations are pioneering untested models and thus carry a higher level of risk. The report concludes that these "frontier" opportunities require risk-tolerant investors who are willing to take big bets to open up these new sectors and potentially achieve transformative impact[13].

Interviews with fund managers confirmed the existence of this frontier gap in South and Southeast Asia. Balanced Early and Impact First funds invest in these "frontier" SMEs. Even within these categories there is a spectrum of how "frontier" – and thus risky – SME models are. Some SMEs targeting the BoP or LMI populations are bringing models tested at least to some extent in other regions while others are pioneering completely new models. Funds have engaged donor agencies, governments, and private philanthropists who are willing to take a high risk in return for potential high impact even without a high financial return. Examples include the Bill & Melinda Gates Foundation's investment into Root Capital, the IFC's investment into SEAF Bangladesh (through

12 Ibid.

13 Bannick, Goldman and Kubzansky. Frontier Capital: Early Stage Investing for Financial Returns and Social Impact in Emerging Markets. Omidyar Network. Oct 5, 2015. https://www.omidyar.com/sites/default/files/file_archive/insights/Frontier%20Capital%20Report%202015/ON_Frontier_Capital_Report_complete_FINAL_single_pp_100515.pdf

the IFC SME Ventures program), and the CDC Impact Fund's investment into the Insitor Impact Asia Fund.

4.3 Building the Impact Investment Ecosystem

Market analysis highlighted constraints and difficulties associated with the nascent nature of the impact investment market in the target geographies. Few global funds are active in the region, while regional and national level funds are attempting to build local ecosystems for SMEs with impact-oriented business models, supporting SMEs to get to growth stage with the goal of raising follow-on investment from larger funds. It is also important to note that the market research found distinctions between the SME and start-up ecosystems for SMEs pursuing proven business models targeting middle class customers and SMEs developing unproven models focused on populations most excluded from the market. A fund manager interviewed gave the example of the rapid rise of the technology start-up ecosystem in Vietnam with multiple incubators and investors arriving from Silicon Valley. This support does not extend to the-impact oriented SMEs his fund invests in, and one of his main challenges has been incubation support funding for these companies[14].

Interviews with fund managers found that funds provide two types of Technical Assistance (TA) or non-financial support in addition to financial investment. One type can be categorised as active investment management whereby the fund team provides non-financial support to investee companies in addition to the investment. Typical forms of support are access to networks and business strategy advice. This type of support is funded from the fund's management fees. The second type of TA found were TA facilities—or pools of funds specifically provided for TA—in addition to active investment management. Examples of activities funded by TA facilities include grants to investee companies to cover costs of improving their environmental, social, or governance practices, for example, paying for an environmental practices audit and certification.

Fund managers of Balanced Early and Impact First funds most frequently cited the provision of TA as the key to success of their investments but had limited funds they could spend on it. These fund managers have limited capital to spend on investment management and the pressure to keep fund management fees low results in managers running very lean operations. However, fund managers claimed that the ability to hire an additional portfolio manager to support investee companies, or a monitoring and evaluation expert, would have significant positive impact on the funds' performance.

[14] Fund manager interview

Conclusions

05

5. Conclusions

A spectrum of models and opportunities

There is a spectrum of opportunities for investors in the impact fund market in South and Southeast Asia with varying levels of risk, potential for financial return and potential for impact. The segmentation of impact funds provided in this market snapshot seeks to provide prospective investors with an overview to identify the category of funds that align with their unique goals and objectives:

- Impact investing funds in South and Southeast Asia encompass a range of models which can broadly be divided into four categories based on: the stage of SME they invest in, whether they pursue an implicit or explicit impact thesis and whether they target risk-adjusted market rate or concessionary financial returns. Although all categories are, by definition, “impact investors,” their respective investments have different risk-return profiles with repect to financial returns and social impact objectives.

- The impact investment market in South and Southeast Asia is nascent and fragmented. Few global funds are active in the region and those that are tend to invest only a very small portion of their portfolios in the region. Smaller regional funds are struggling to both make early stage investments and help build investable SMEs through supporting incubation activities.

- Funds based in the region tend to invest in early stage SMEs. By creating a pipeline of investable companies for the larger funds, these regional funds play an important role in building the impact investment market. They also invest in the most pioneering and unproven innovations, and are primarily focused on businesses that target the BoP or have an environmental impact.

- Raising capital is increasingly more difficult for smaller, regional and national level-funds targeting earlier stage SMEs and unproven sectors. Fund managers interviewed echoed the desire for investors that were willing to take a higher risk to support the nascent impact investment sector in the region, targeting early stage SMEs and innovation at both the fund and investee company level.

- From a financial perspective, the risk of investing in early stage SMEs and unproven business models is not acceptable for most investors. Funds focused on this stage have engaged donor agencies, governments, and private philanthropists who are willing to accept higher levels of risk in return for the potentially higher levels of impact. In a Blended Finance model, these investors seek to leverage traditional investor capital focused on risk adjusted financial returns by taking on a larger portion of the financial risk. Based on interviews with fund managers, there is more appetite for Blended Finance, both at the fund level and on a direct deals basis.

Annex

Funds Interviewed

Anthem Asia

Aavishkaar Frontier Fund

Bridge Philippines Investments

Brummer & Partners - Frontier Fund

EMI Cambodia-Laos-Myanmar Development Fund II

EMI Cambodia - Laos Development Fund I

IIX Growth Fund

Insitor Impact Asia Fund

Insitor Seed Fund

LGT Impact Ventures

Lotus Impact Fund

Mercy Corps Social Venture Fund

Tropical Asia Forests Fund

Nexus Pioneer Facility

Phitrust Asia

responAbility Fair Trade Fund

Root Capital

Sarona Frontier Markets Fund III

SEAF Blue Waters Growth Fund

Small Enterprise Assistance Fund - Bangladesh Venture (SEAF BV)

Soros Economic Development Fund (SEDF)

Uberis Capital Fund

Unitus Impact – Livelihood Impact Fund

Venture Investment Partners Bangladesh (VIPB) Ventures Fund

VilCap/ Kinara