### IMPACT INVESTING: Harnessing Capital Markets to Solve Societal Problems

Josephine Cashman









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### Foreword

Sara Hudson, Research Fellow and Manager of the Indigenous Prosperity Project at The Centre for Independent Studies

here is no doubt that the current service delivery model is failing Indigenous people. Despite billions of taxpayers' funding there has been very little improvement in outcomes, particularly for remote Indigenous Australians. One of the most intractable areas of Indigenous policy is social housing, which is why the project that Josephine Cashman is working on is so important. Back in 1978 HC "Nugget" Coombs declared "there is no element in social policy for Aborigines the results of which have been so disappointing and so confusing as that related to housing." Sadly, very little has changed since then, and the "same old merry-goround of Government funding, with the lack of results and depressing reports that follow" continues. As Fred Chaney, former Deputy Leader of the Liberal Party, has pointed out, the current system is broken and a new service delivery paradigm is needed.

One of the initiatives in recent years to attempt to address societal problems that governments seem unable to solve, is social impact investing. Unlike charitable donations, social impact investment enables investors to have a more direct impact on their favourite causes and receive a financial return for their support. The emphasis on outcomes and measurement inherent in social impact investment also helps to build an evidence base about what works.<sup>3</sup> The Department of Treasury recently released a discussion paper stating

that social impact investing gives the government an "opportunity to fund 'what works' and reinvest spending that would otherwise not achieve beneficial outcome".<sup>4</sup>

Josephine Cashman's report highlights the numerous opportunities that could flow from social impact investment. Not only will her pilot program help to create over 140 jobs a year and contribute to a supply chain of businesses and home ownership it will also result in substantial government savings. Albert Einstein reportedly said that the definition of madness is to keep doing the same thing over and over again and expecting a different result. It is time to abandon the failed service delivery models of the past and try something new.

### **Endnotes**

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- 4 Federal Government, 2017, 'Social Impact Investing discussion paper', page 3.

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ince the Global Financial Crisis, there has been a pronounced loss of faith in the free market economy. This has been coupled with increasing dissatisfaction over government being unable to reign in its spending—and wasting taxpayer money on poorly-judged social programs and infrastructure.

However, in the post-GFC environment — with a strong focus on the risk-and-return matrix and corporate reputation threats — capital markets are becoming increasingly attracted to the social impact investing an approach that could both restore faith in a capital free market economy and prevent excessive government waste on social programs and infrastructure.

Impact investing offers opportunities for investors with a commitment to social responsibility to invest in solutions to entrenched societal problems for both capital and social impact returns. Successful impact investing applies well-designed solutions to problems such as overcrowded social housing and employment programs for at-risk populations. It harnesses the speed and efficiency of capital markets and, at the same time, prevents wasteful government spending.

This paper will examine the politicisation of financial policy since the GFC. In addition to outlining how impact investing functions, and the opportunities it creates, it will explore how impact investing could revolutionise results for disadvantaged Aboriginal and Torres Strait Islander communities. I will touch on some of the work of the Big River Impact Foundation, where we are working with tier-one businesses in a positive demonstration of corporate collaboration and problem-solving to create Indigenous impact fund products.

### Pinpointing the problems

I do not wish to delve into the causes of the GFC, but rather inspire new ways of thinking that are developed from the principle of enlightened self-interest, and bring the strengths of the capitalist financial system, including its speed, risk processes and results-driven culture, into solving endemic societal problems.

Most people lack understanding of the complexities of the financial system, so it is easy for biases to emerge. This creates an environment where governments and individuals seek to blame sections of the economy for all their financial woes—and has led to a substantial amount of post-GFC scapegoating.

There can be no doubt the US financial system failed in 2008. However, the banking sector was not solely to blame. It was a compound moral crisis that led to the GFC. We have seen scandals involving the banking industry here in Australia and, while we cannot change the past, we are all responsible for these moral and ethical failings, and share a vested interest in ensuring that we do not repeat history for future generations.

If we do not address challenging issues within our democracy and financial system, we run the risk of outside interests, including maverick governments, over-taxing and regulating the financial services and banking industry to the extent that this has a negative impact on growth, and areas of financial and social innovation like impact investing. The politicisation of financial policy, is evident even here in Australia, where our Coalition government supposedly supports a free-market economy, but is now taxing big banks to provide itself with more money to spend on social programs, health and infrastructure.

For those of us who believe in a free-market economy, this is a bitter pill to swallow when coupled with the fact that governments appear to be inept at solving social problems—and waste a substantial amount of money in their failed attempts to do so. For those of us who do not want our taxpayer contributions to be wasted, this is a huge concern. It is not uncommon, for example, for infrastructure projects to blow out over budget by billions of dollars. In Indigenous affairs, we see less than 10% of all programs properly evaluated, and have no idea whether government spending is truly meeting our needs. If a company ran a business like this, it would go bankrupt and find itself without investors or customers.

Driven by our 24-hour news cycle, politicians and political parties are spurred by different agendas day-to-day. Their interests can vary in their efforts to attract votes, influence opinion polls, and leverage support within their own factions and parties. Our

bureaucrats, who usually make the ultimate funding decisions based on the policy of the day, cannot be held to account for previous policies relating to funding.

### Why impact investing offers solutions

In contrast with government funding, impact investing—by its very nature—must have a strong level of rigour and stability. Investors deploy their capital and take a certain level of their own risk and, therefore, a clear risk-and-return matrix must be developed before any capital can be deployed into impact investing projects. Therefore, the primary driver for investors is the return of positive social, financial and—in some cases—environmental impacts over the longer term. Impact investing aims to generate beneficial and measurable social or environmental impacts alongside financial returns. Impact investors can include trusts, foundations, and institutions including super funds, not-for-profits, and individuals.

In Australia, more than 67% of investors expect impact investments to be a significant part of their portfolios in coming years, with active investors looking to triple the size of their impact portfolios within the next five years.<sup>2</sup> The Australian market is expected to grow to \$32 billion by 2021. In 2015 alone, 157 impact investors committed USD\$15.2 billion in 7,551 impact investments globally.<sup>3</sup> The target sectors included food and agriculture, healthcare, housing, energy, education, microfinance, and other inclusive financial services.

Impact investments, as an alternative asset class, are emerging globally as an attractive investment option with limited correlation to traditional forms of investment. In the UK, investment is predominantly from philanthropic foundations, while in the US, larger investment banks like Goldman Sachs have acted as investors.

There are three types of innovative impact funding models currently being used globally:

1. Social finance and impact investment are investments made into companies, organisations, and funds that provide services that meet a social need with the intention of generating measurable social and environmental impacts alongside a financial return.

- 2. There are payment-for-outcomes and contracting arrangements whereby governments financially reward providers, and sometimes private investors, for having a positive measureable impact on the lives of service users.<sup>4</sup>
- 3. Finally, social impact bonds are an example of a payment-for-results model. These are a vehicle for private investors to provide upfront capital loans to fund service providers to achieve agreed social outcomes. Investors receive a return based on the achievement of agreed social outcomes. Governments save on costs if agreed outcomes are achieved and these saved funds can be used to repay upfront investments and generate financial returns.

The current government grant regime desperately needs reform, not least because it is embedded in red tape. NGOs with several different types of funding streams from federal, state and philanthropic sources waste resources acquitting grants, rather than providing services. For example, a small Aboriginal NGO—that straddles these federal, state and philanthropic jurisdictions—at one point had more than 100 grants to acquit annually. The short-term nature and lack of an overall theory of change, and the lack of sector and funding collaboration, can see the same type of programs duplicated within many communities. The Forrest Review provided stark examples of places like Wilcannia, where there are as many programs as there are people.

Impact investing, by its very nature, remedies this by taking a longer and deeper look at problems and solutions. Investors demand a business approach, which means lean operations, continual monitoring, collaboration, oversight, and results.

Impact investing is different from corporate social responsibility (CSR), social responsible investing (SRI), and environmental, social and governance reporting (ESG). Understandably, many are confused by these myriad definitions. Impact investing has an important distinction from other types of do-good corporate social participation and investment principles. The global definition of impact investing comes from the Rockefeller Foundation, which coined the term in 2007:

Impact investments are investments into corporations, organisations, and funds with the intention to generate measurable social and environmental impact alongside a financial return.<sup>5</sup>

Despite the impressive capital and interest in impact investing, it is important to note that, even with the current growth in impact investing, it is still insignificant compared to the mammoth amounts invested by other groups—including governments with grant rounds, corporates through their CSR spending, and philanthropic donations.

But impact investing is compelling for its potential to find market-based solutions to endemic societal issues. Such investments have the potential to scale up quickly in partnership with government, industry, and other stakeholders. And impact investing is all about finding solutions through such collaboration.

For a pointed example of the transformative power of impact investing and its scalability, one only need examine the success of the Indian microfinance sector. The microfinance movement in India was created by social entrepreneurs seeking to create a scalable impact—it was, in fact, supported by India's earliest impact investors. This has since generated a US\$8-billion industry, and is now part of the main banking and financial services offered in India.<sup>6</sup>

### Why CSR and welfare are not solutions

In contrast, CSR has not created the same positive impact in India. In 2013, India's parliament enacted a section within the Indian Companies Act prescribing a mandatory spend of 2% on CSR of average net profits for all companies meeting a specified financial threshold. Recent reports and analysis have found that this law failed to create the legislative intent to have companies positively impact on many of the great social challenges facing modern India. The reports found that the law failed because of poor design, lack of clear obligations, and poor law enforcement that did not generate a natural ethical obligation for companies to obey this law. Spending without a clear plan and framework will always fail. It fails in both the corporate sector and the government sector. Welfare does not assist

communities or individuals to propel them out of poverty. Rather, it creates a sense of lethargy and hopelessness.

Sara Hudson's 2016 Centre for Independent Studies report, 'Mapping the Indigenous program and funding maze', outlined the total failure of government spending to alleviate chronic poverty, particularly among those who live in rural, remote, and very remote areas. Hudson highlighted that "there is much goodwill in Australia to improve Indigenous outcomes, however, too many programs are implemented because of their perceived benefit, rather than a rigorous assessment of *a priori* evidence."

Hudson's research examined total spending on Indigenous programs, and estimated this to be at least \$5.9 billion annually, comprising federal government expenditure of \$3.28 billion, state-and-territory government expenditure of \$2.35 billion, and income sourced by the Indigenous not-for-profit sector of \$224 million. Sadly, less than 10%—just 88—of these 1082 programs had been evaluated either during or after implementation. And, of those programs evaluated, few used methods that could truly provide evidence of the program's effectiveness. Hudson outlined numerous issues including multiple service providers and NGOs operating with overlapping priorities within the same parameters with little evidence of success, and she argued that funding is not necessarily going to where it is most needed.

What a mess! It's no wonder Indigenous Australians are frustrated, and that average taxpayers would be scratching their heads to understand this tragic failure.

### Statistics of failure

For depressing reading about failures in Indigenous affairs, one can go straight to recent federal government reports, including two Productivity Commission reports on 'Overcoming Indigenous Disadvantage', and 'Indigenous Expenditure', the Australian National Audit Office's report on the implementation of the Indigenous Advancement Strategy; and the Closing the Gap Report and its accompanying Prime Ministerial statement. These detailed evidence-based reports provide a frightening window into the lives of Indigenous people, particularly in remote Australia.

The 2016 Australian Bureau of Statistics census shows that a little over 20% of Indigenous Australians live in remote communities, a total of approximately 150,000 people<sup>8</sup>. There are very good areas of progress for Indigenous Australians, mostly in urban environments. But unless we can address the overwhelming crisis in remote Australia, the Close the Gap report will show the same failures every year. The key issues in remote Indigenous Australia are the lack of an economy, and the lack of infrastructure to create an enabling environment to support local economies and sustainable remote communities.

Australians living outside remote Indigenous communities enjoy an enabling environment for themselves and their families. They have access to parks, playgrounds, cinemas, shopping centres, roads, power, water, sewerage systems, telecommunications, housing, health services, education, community safety, policing, and professional services that mostly do not exist in remote Indigenous communities. A 2015 infrastructure audit of the 73 largest remote Indigenous communities in the Northern Territory found that less than 50% had mobile and data services. Only 26% had standard town planning regimes, less than 50% had a permanent police presence, and housing met only 60% of demand. Nearly all had no sealed transport services, ensuring that those in the north are inaccessible by land for half the year due to flooding.

The impact of this lack of infrastructure is devastating for Indigenous women. When you go home tonight, take a minute to imagine what it would be like to manage your three-bedroom household if you had 15 people living in it, if you only had one stove, if you didn't have a landline, internet or mobile phone, if the water and power regularly didn't work, and if there wasn't a Bunnings around the corner that enabled you to manage your own repairs for basic problems like a leaking tap. It can take more than a month to fix this through the current bureaucratic system. Imagine trying to raise your family in those circumstances. Could you get your kids to school? Could you support their homework? Could you or your partner go to work? This is a barren desolate scene that is lived daily by tens of thousands of Indigenous women across remote Australia.

The solution is to build enabling environments across remote Australia. This will require billions of dollars of investment over coming decades. Most importantly, this infrastructure investment must be leveraged to support sustainable remote communities by facilitating local and regional economies.

For most social and economic indicators, average outcomes for Indigenous Australians living in remote areas are poorer than those living in major cities and regional areas. Indigenous Australians living in remote areas have poorer reading, writing and numeracy results in Year 3 at less than 55%, and student performance declines with increased remoteness. In 2011, the proportion of Indigenous Australians aged 20–24 years with a Year 12 education or higher was greater in less remote areas, ranging from 64.1% in major cities to 30.7% in very remote areas. Home ownership also declined with increased remoteness for Indigenous Australians in 2012–13, decreasing from 38.4% in major cities to 38.1% in inner regional areas, 29.7% in outer regional areas, 19.7% in remote areas, and only 5.1% in very remote areas.

These data indicate the critical social and economic disadvantages prevalent in remote Indigenous communities, which both contribute to and are reflected by low levels of employment, a high degree of welfare dependence, and a lack of economic development. Indigenous home ownership has been identified by some remote communities as a pathway towards alleviating this disadvantage. 10

This is exactly where impact investing can play a part. Obviously, governments cannot afford—or do not have the infrastructure—to invest the types of capital needed to deliver a sufficient enabling environment to many of these communities. And impact investing, rather than social spending without return, is the correct mechanism to create the substantial change required. With the development of industry and with our Asian neighbours in north Australia, many of these small communities could become sustainable.

I listened to the Human Services Minister Alan Tudge's recent speech at CIS about welfare dependency, and found it to be completely uninspiring. Family values and getting off alcohol and drugs are important. However, when you look at disadvantage in impoverished Indigenous communities, you will find a familiar thread and causal

effect. This causal effect is housing—or rather, the considerable lack of it. When you examine the Aboriginal and Torres Strait Islander Healthwork Framework, you can clearly see the massive social, financial and health impacts of household overcrowding. The health impacts of this cannot be underestimated.

At the 2017 Garma Festival, I was moved by the Gumatj clan's performance before the Prime Minister and Opposition Leader in tribute to the late Dr G Yunupingu, who died tragically from a kidney-related disease. The high incidence of kidney disease in remote Indigenous communities can be directly related to overcrowding conditions. Skin diseases in early life are also symptomatic of overcrowding and have a causal link to later kidney disease.

It appears governments have failed through their funding regimes to deploy adequate and reasonably-priced housing. In some communities, houses cost more than \$1 million each to build, and usually generate few or no local employment opportunities. In the worst-affected areas in the Northern Territory, there are 19 adults and children per room.

There is no lack of capital for social impact investing in Australia. Rather, the challenge has been the ability to deploy capital effectively given the lack of credible and worthy projects. Governments should partner with social entrepreneurs, investors, sponsors, and investment managers to collaborate in creating public–private partnerships that generate local jobs, local empowerment and the much-needed deployment of social infrastructure to create healthy enabling environments in remote Indigenous communities. Ideally, governments would partner with investors in co-funding impact investing projects. Instead of punishing banks and using them as scapegoats, they should provide greater stimulus and incentives for banks and investors to invest in impact investing to solve intractable social problems.

### Consortium for a new approach

For the first time in history, we have brought together a consortium of nationally and globally recognised companies to lead Australia's first social impact investment fund. Its focus is on investing in remote Indigenous communities. The consortium is brought together by

Big River Impact Investments Pty Ltd and the Big River Impact Foundation, which is directed by myself and Professor Marcia Langton, among others.

Our corporate consortium is made up of Allens Linklaters for legal and taxation, and Perpetual for capital access, funds and asset management, trustee, and registrar. It brings together an unprecedented level of Australian and international expertise in the financial industry, capital raising, investment, trusteeship, legal advisory, social impact investing, and direct knowledge and experience of remote Aboriginal communities. We have also partnered with Norton Rose Fulbright, Ashurst, Brightlight investment managers, Marsh insurance brokers, IAG, Deloitte, and EY.

While Big River Impact Investments is a new company, our consortium has the proven expertise and experience to be a first mover in the social impact investment market in Australia. The Big River Impact Foundation and its social partners, which include Google, Infoxchange, and Good Shepherd Microfinance, will work with community leadership groups to co-design and build a robust digitalised framework for ensuring long-term social returns from our projects.

Each member of our consortium brings unparalleled credentials and reputation to the market with proven delivery capability in their respective areas, and a demonstrated commitment to improved outcomes for Indigenous communities.

We are excited about our projects, but as we are currently engaged in confidential discussions, we cannot disclose our own pipeline of opportunities just yet. What I can say to you today is that our pilot project is a private sector driven enterprise, with private sector capital invested with an emphasis on creating substantial government savings. We have a focus on community empowerment, local job creation of over 140 jobs a year, developing a sustainable Indigenous supply chain of businesses and home ownership. We are concentrating our efforts on remote communities with stable local leadership. Aboriginal and Torres Strait Islander communities desperately need this empowering support rather than the continuation of the same old merry-goround of government funding, with its subsequent lack of results and depressing reports.

Impact investing will inspire and implement a far better solution. Using the approach of the capital markets means that when there is a price on something and there is a much more effective investment thesis, capital can operate with lightning speed. I am excited about the future opportunities that a more mature impact investing industry can deliver when we can price social returns, and the market can work with investors to create the rapid change needed to build a better world.

### **Endnotes**

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### IMPACT INVESTING: Harnessing Capital Markets to Solve Societal Problems

In the post GFC environment, with the risk and return matrix and reputation risk to corporations and financial institutions, capital markets are attracted to social impact investing. Impact investing, or social impact investing, offers opportunities for investors with a commitment to social responsibility to invest in solutions to entrenched societal problems for both financial and social returns. Successful impact investing is applied to well-designed solutions to problems such as overcrowded social housing and employment programs for at-risk populations to harness the speed and efficiency of capital markets, and, at the same time, prevent wasteful government spending.

Josephine Cashman is a Worimi entrepreneur from New South Wales. She is a lawyer, business woman and social entrepreneur and sits on the Board of the Sydney Harbour Federation Trust and is the Deputy Chair of Gadigal Information Services. She is also the founder of the Big River Impact Foundation, Big River Impact Investments Pty Ltd and Riverview Global Partners Pty Ltd. Recently Josephine addressed the United Nation's full Human Rights Council on violence against Indigenous women and is widely acknowledged for her social advocacy work.



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