Impact Investing

A handbook for foundations

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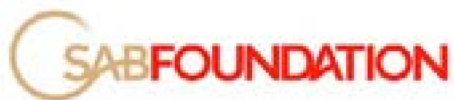

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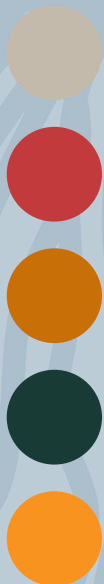


About this report

This report was produced by Krutham for Impact Investing South Africa and was funded by the SAB Foundation, FirstRand Empowerment Foundation and the Standard Bank Tutuwa Community Foundation. It was published in November 2024.

About Impact Investing SA

Impact Investing South Africa is a cross-sectoral initiative aimed at building the ecosystem to accelerate the deployment of capital that optimises financial, social and environmental returns. Impact Investing SA is a national partner of GSG Impact. The foundations' working group aims to increase local foundations' engagement with impact investing by way of their grant/catalytic capital as well as their endowments. For more on Impact Investing SA, go to https://www.impactinvestingsa.co.za/

About the SAB Foundation

The SAB Foundation is an independent Trust and Small Business Funding Entity set up in 2010 as one element of the broad-based black economic empowerment transaction conducted by South African Breweries Ltd. Its mandate is focused on entrepreneurship development with a priority focus on women, youth, people in rural areas and people with disabilities. It specifically targets a truly national reach through three broad programmatic areas, namely general entrepreneurship in any sector, social & disability innovation and farming. Since its inception, it has invested close to R700m in grants, business support and interest-free loans. Latest statistics as of 2024, show entrepreneurs creating 12,609 new jobs and turnover increasing by over R1bn. In recent years, the SAB Foundation has also invested R95m in equity and concessionary loans for its programme graduates to facilitate their growth. For more on the SAB Foundation's programmes and case studies go to www.sabfoundation.co.za

About the FirstRand Foundation and FirstRand Empowerment Foundation

The FirstRand Foundation (FRF) serves as the corporate foundation. The FRF's vision is a financially inclusive society with equitable access to sustainable economic growth. This is achieved by empowering communities to be active participants in the broader South African economy.

The FirstRand Empowerment Foundation (FREF) serves as the independent foundation that was established as part of FirstRand's black economic empowerment deal. FREF's key objective is the reduction of poverty and inequality by undertaking and/or supporting public benefit activities that result in broad-based black economic empowerment (B-BBEE). This is achieved by empowering organisations that serve as the foundation's implementing partners.

About the Standard Bank Tutuwa Community Foundation

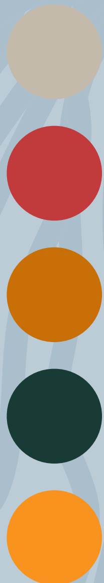
The foundation is a non-profit organisation that aims to create an enduring, positive legacy stemming from the Standard Bank Group's successful B-BBEE scheme. The primary focus rests on three essential areas: early childhood development, schooling and work opportunities for youth.

Find out more on the SBTCF at: www.tutuwafoundation.org.

About Krutham

Krutham, previously Intellidex, is a leading research and consulting firm that specialises in the financial sectors of emerging markets and their social impact. Its analysis is used by companies, investors, stockbrokers, regulators, policymakers and companies in South Africa and around the world. It has offices in Johannesburg, London and Boston.

acknowledgements



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Disclaimer

This handbook is based on information believed to be reliable, but Impact Investing SA, the SAB Foundation, FirstRand Empowerment Foundation, Standard Bank Tutuwa Community Foundation and Krutham make no guarantees as to its accuracy. They cannot be held responsible for the consequences of relying on any content in this report.

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foreword

We can achieve more by learning together

With the worlds of philanthropy and investment merging to deliver improved social outcomes, this book is a timely guide for foundations to improve their understanding of how financial markets work.

By Bridgit Evans, executive director: SAB Foundation

As social change agents, our goal is to have the maximum positive impact on the issues we are tackling. This is what motivates and inspires us. However, mingled with the sense of victory we feel when we know that we've made a difference in people's lives, many of us are kept awake at night by the sheer scale of the growing social, environmental and economic inequalities in the world, wondering how we can achieve significantly more scale with finite resources.

Part of the answer lies in using some of our available financial resources differently. While programme-related grant-making still plays and always will play a critical role, impact investing holds significant promise in enabling us to achieve impact at a scale in some sectors that is not possible through grant funding alone.

Globally, the fields of investment and philanthropy are moving closer together, but this is not without its challenges. Most people who choose to work in a philanthropic setting did not study finance and investments, and many who did and now work in impact investment, do not necessarily have a strong understanding of what impact really means or how to measure it. We are having to learn from each other and tertiary institutions need to adjust their teaching to bring together students and ideas from faculties that used to sit on opposite sides of the campus. The enormous benefit to having such different types of thinkers around one table means that impact investing is a dynamic and evolving field and there is no doubt that we can achieve more together than apart.

We commissioned and wrote this guide as a reference document for those who have had very limited exposure to finance, to help create a basic level of understanding. However, finance is a complex subject that takes years of study and it is not realistic to expect a technical understanding from reading it. We only hope that it may help you think differently about what is possible and that it may lead to more collaboration across organisations and sectors to achieve greater impact.

We hope you find it both interesting and useful.

introduction

Amplifying impact

Philanthropy is about doing good in the world. For the most part, philanthropies, including foundations, fund and manage programmes that aim to achieve positive impact. This can be through social development of people and communities, charitable interventions to help vulnerable people, or campaigns and projects to improve environmental performance. The impact we pursue reflects the mission and objectives of our foundations. We aim to have as great an impact as possible, given our finite resources.

Many foundations grapple with the best strategies to achieve their aims. Should our strategies be programme-based, aiming to directly intervene in people's lives through our own programmes, or should we be making grants to outside organisations? Should we rather be focused on systemic change, intervening at the institutional level to improve public sector performance? These and many other questions have shaped the strategies of foundations across South Africa. Increasingly, however, foundations have been hearing about a further strategy that could assist in achieving their aims: impact investing. This guide is intended to equip foundations with insight into this approach and help with initial steps in using it.

We are all aware that the scale of challenges that exist in the world requires a pool of funding that is far greater than ours. We also know that there are vastly more resources in the world than our funding alone. What if we could unlock a bigger pool of funding to deliver a greater impact?

What if we could drive impact by using our resources in a different way, funding innovation and social enterprises that have the potential to accelerate and scale impact far faster than we can through our programmes? And what if there was an opportunity to have some of our funding returned to us so we are able to use it again to invest in other impactful opportunities?

These questions are taken increasingly seriously in the global philanthropic sector. Some foundations are discovering that by channelling their financial resources in a different way, the outcomes they achieve can be magnified. We provide many examples in case studies throughout this handbook. We have found like-minded partners among investors, governments, companies and social enterprises who can collaborate to contribute their respective strengths in a way that delivers far greater impact than any could achieve alone. This activity is collectively referred to as impact investing, though the term is not very precise, as we discuss in this guide.

Why impact investing?

The promise of impact investing is that philanthropy can use its limited financial resources to magnify positive outcomes and potentially recycle some of its funds to be used again.

While the world of philanthropy is having this conversation, over in the investment world many are realising that systemic sustainability depends on using their resources to achieve desirable social and/or environmental outcomes, rather than just a financial return. This means that the two worlds are increasingly finding common ground, with philanthropists collaborating with investors to achieve unprecedented change.

Philanthropy, and foundations in particular, have an important role to play in this new world. Philanthropy has the expertise to analyse social challenges and assess what interventions could be effective and the skills to assess whether outcomes are being achieved. Investors understand investment vehicles and structures, accounting and financial markets, institutions and concepts that usually aren't part of the philanthropic world.

This handbook is intended to aid the philanthropy sector, foundations in particular, to understand the nature and opportunities of impact investing. It does not assume any financial knowledge on the part of user, though we introduce and define several concepts that help understanding.

Broadly, there are two approaches that foundations can take to impact investing, undertaking it at the level of its programmes, called programme-related investing, and at the level of the endowment, called mission-related investing. We explore these two approaches in the first chapter, but the promise of impact investing is that it can make programme spending more effective and ensure alignment of an endowment to enhance the foundation's mission.

Impact investing is about enhancing the delivery of a mission, not changing it. A key concept in that process is to think of the foundation's resources as catalytic in the sense that the foundation can spark and accelerate the flow of resources optimally to achieve social and environmental goals in a way that magnifies impact far beyond what the foundation's own resources could achieve alone. The fact that impact investment can generate a financial return presents an opportunity to recycle funds into other projects, extending the financial resources of the foundation beyond the one-time use of grants (Faella, 2023).

Who this handbook is for

We have written this handbook for philanthropic funders and foundations that deploy funding either from their sponsors or from an endowment. Their focus is on delivering social impact and this is potentially a means to maximise that impact. In producing this handbook we interviewed several foundations that have walked the journey of building an impact strategy to ensure it reflects their experiences.

It is also for foundations already in the trenches that want to refine and strategically embed their impact investing activities into their broader strategy. We draw on international research and case studies to do so.

This handbook can also be used to engage foundation boards and trustees to demonstrate what is possible beyond grant-making and to raise and develop strategies to address some of the key challenges.

It is also for all philanthropic funders that want to explore how they can move beyond grant funding to catalyse and enhance impact.

Further, this guide can be useful for any parties other than philanthropies looking to better understand impact investment – particularly from the perspective of a philanthropic funder.

Key considerations when using this handbook

We have written this handbook to support philanthropic funders on their impact investing journeys. It is a practical resource with several examples of how others have implemented impact investing strategies and includes a list of additional resources that will provide deeper insights on specific topics covered in this handbook. The handbook first provides an overview of impact investing before outlining basic steps for funders to introduce impact investing in their funding strategies.

The intention is for it to be a useable handbook. Every foundation is different, and your impact investing journey must be designed for your own purposes. However, we have aimed to give you practical steps to take to do so. By following the steps in this book, you can put in place the policies and resources needed to become an impact investor.

While the research team has exerted every effort to ensure the comprehensiveness of this handbook, it is inevitably limited by the input and perspectives from our research and those we interviewed in its compilation. It is not an exhaustive view of the nuances of impact investing by foundations. To support further insight, we provide a list of useful resources for further exploration in the appendices.

It is important to note that this handbook is not investment advice for foundations and does not constitute recommendations on capital deployment for impact investing purposes. As we explain in this guide, there will be times that foundations should seek professional advice to support their journey to becoming impact investors.

the basics

1

What is impact investing?

Foundations typically direct spending towards people and organisations that deliver certain outcomes. It is the outcomes that matter – whether it is improving people's life prospects by giving them access to better education, ensuring better access to nutrition for children. or programmes to improve job prospects for young people. Foundations build expertise in managing programmes and measuring outcomes. They are often able to deliver public services and development more effectively and efficiently than governments. This is what we mean by **impact**, which we can define as "a change in an aspect of people's well-being or the condition of the natural environment caused by an organisation" (Impact Management Forum, 2023).

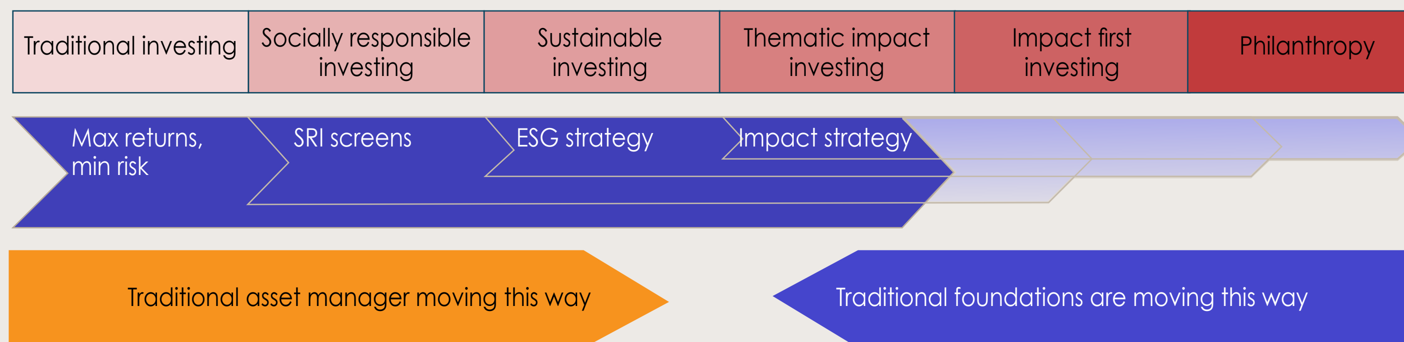
This world has traditionally been seen as quite different to investing. We typically think investing is from the world of finance, involving a completely different skills set and knowledge base. And yet there are clear common elements. If we want to build a hospital or a university, it takes a considerable investment of money to make it happen. But we don't build these things just because we want new buildings – we build them to deliver the social outcomes that hospitals and universities are needed for. The success of such an investment is improved health or educational outcomes that we desire. These outcomes are the return on investment.

One way to think of traditional grant-making is that it is a kind of investment, but one that delivers social returns rather than financial returns. Foundations are good at assessing those social returns. We can choose between different projects by how much of a social return we expect. Just like financial investors, we aim to maximise our returns, but they are expressed in social terms.

Traditional investing is also about allocating money, but instead of a

Figure 1: The Spectrum of Capital.

As traditional investors realise the importance of the social and environmental consequences of their investments, they are moving towards investment strategies that are in tandem with the issues that philanthropy typically works on. At the same time, philanthropies are becoming more conscious of the usefulness of investing to deliver on their missions. This creates the opportunity for collaboration



social return we expect a financial return. That financial return is assessed through the financial performance of the investment, including the money it returns to the investor and the value of the asset. But as the examples of hospitals or universities make clear, investment can also have positive social consequences.

Impact investing brings these two worlds closer to each other. An investment can have both social impact and financial returns. This is often the case for investment – when our pension funds invest in companies, they often create jobs and have other positive social outcomes (though they can also create negative ones, like inequality and CO_2 emissions).

In the traditional investing approach, these positive (or negative) social outcomes are "externalities", things that are external to the reasons for the investment. Such externalities can be nice to have but are seldom explicitly considered in investment decisions.

Much of the discussion around the world over the last decade has been about how to get traditional investors to be more conscious of these externalities, indeed, to make them part of the investment decision. When traditional investors start doing this, they are becoming impact investors. In doing so, they have had to develop ways to measure the impact of their investments.

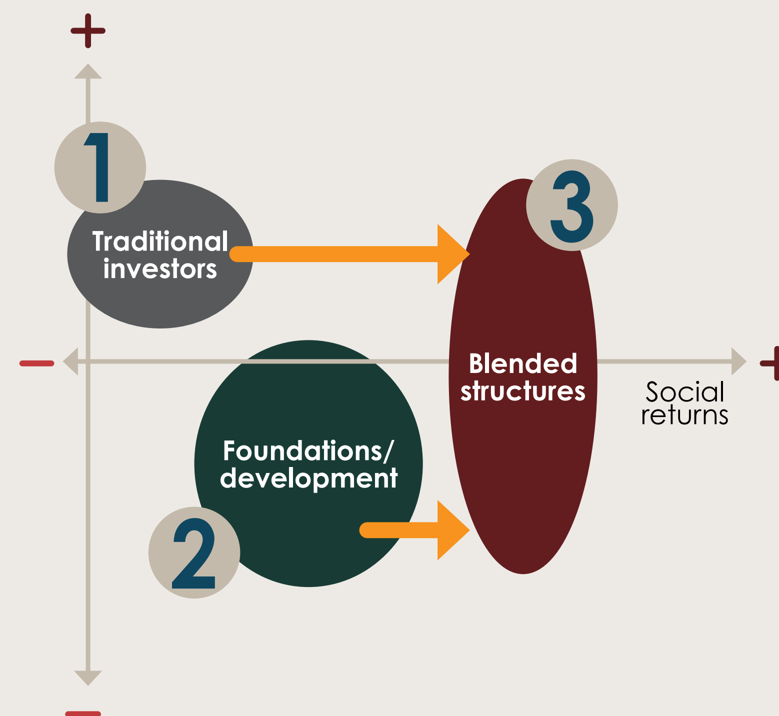
There is an equivalent discussion on the other side of the coin, among philanthropists who are recognising that impact investing could deliver their social objectives, but also generate a financial return that can help fund even greater delivery. Not only that, but certain kinds of social objectives might be even better achieved by backing social entrepreneurs and their enterprises, than by providing grants only.

There is a sweet spot that can be found in the middle of this spectrum of motives (see Figure 1) where philanthropists and traditional investors meet. Philanthropists may be biased toward generating social returns, and the investors toward financial returns, but both can now consider the other's objectives. In doing this, there is a possibility of significantly magnifying the social returns, by directing vastly more financial resources towards them, but in the process giving investors the financial return they expect , while adding the social returns they increasingly also want. When traditional investors and philanthropies combine their funding in this way, it is often called "blended finance" (see Figure 2).

Of course, working with traditional investors is not necessary for impact investing. Foundations can undertake impact investing of their own without any other investors being involved. This idea of blending different sources of funding is an important objective that can help scale impact. But foundations can back social enterprises that can deliver large scale social impact without worrying about other investors. Many foundations start with small investments in this way.

The first thing for foundations to know about impact investing is that they already have a vast amount of valuable knowledge – they can understand the impact side better than traditional investors. The knowledge gap they need to close is often the investment side. This guide is intended to help traverse this gap. But foundations and their staff should not be intimidated – they bring important insights to the impact investing conversation. Adding some of the strategies and approaches from the investment world can enhance their impact. Foundations can step into impact investing very gradually and without taking big risks. Before we talk more about impact investing, let's take a step back and talk about investing in general.

Figure 2: The aim of blended finance



1 A traditional investor will aim to maximise financial returns and minimise risk. Such an investment will also have some social benefit, such as the creation of jobs.

2 A foundation can afford below-market financial returns to achieve positive social returns.

3 By pooling money, the foundation's investment can be used to catalyse commercial investors, resulting in greater social returns than it can achieve alone.

What is investing?

As investors have been having to learn a new set of concepts to understand impact and how to measure it, philanthropists are having to learn more about the traditional investment world. This can be daunting, given the often-bewildering language and terminology that is used in finance. Here we demystify a few key concepts to help navigate this world.

Putting money to work

Traditional investing is simply allocating money with an expectation of getting that money back plus an additional financial return. This return is usually called the **yield**, which is simply the return investors get for their investment, often expressed as a percentage. We typically talk of **financial instruments** as the things that people are putting their money into. A financial instrument is anything that generates a yield. A bank deposit is a financial instrument, because you put money into it and get it back with interest either on demand or after a fixed term.

The main types of investment

The most common categories of financial instruments are debt and equity. **Debt** is pretty simple – anyone who has borrowed from a bank or other institution has been exposed to it. When we borrow from the bank it is creating a financial instrument in the form of a loan to us. The bank expects to get its money back plus interest for that loan. The interest the bank earns on the loan is compensation for the risk it shoulders (such as a possible default) when granting the loan.

We can lend money to companies in much the same way. This can be through various types of financial instruments including straightforward loans through a loan agreement. We lend money to the company with the expectation that it will pay us back plus interest.

Most investors are institutions that are managing other's people's money. Anyone who is a member of a pension fund is entrusting that pension fund to invest their savings and deliver returns. When you deposit money in a bank, that bank looks after it and lends some of it out to other clients. These institutions have a big responsibility to invest prudently and to avoid losing their clients' money.

The important feature of debt is that the borrower must pay back the principle (the amount borrowed) plus interest, no matter how they perform. This implies risk because if the borrower performs worse than expected, then it may be unable to meet its obligations to lenders and could face bankruptcy.

There are many different kinds of lenders, from government institutions like the Industrial Development Corporation, to the major banks, to retailers who provide store credit, to non-bank microlenders, to private companies including those which extend credit to their customers, and of course individuals.

TIPS

The "Glossary of terms" at the end of this guide can help you understand any unfamiliar investing terms in this guide.

Foundations, too, can become lenders like these. We'll discuss other examples of debt in Chapter 3.

The other major category of financial instrument is **equity**. We have equity when we have an asset like our home that is worth more than the debt that we owe the bank. The difference between the value of the home and the debt is our equity. Equity is usually talked about in the context of companies, but it means the same thing – the value that belongs to the owners of a company once all obligations are settled. When an investor takes equity in a company, it means that they own a piece of the company. We give examples of equity investment in Chapter 3, but any ownership stake in a company counts.

Equity plays an important role in protecting lenders. If a company underperforms, losses can be absorbed by equity before the lender faces any risk. This is factored into the cost of borrowing, with lenders willing to reduce interest rates if there is substantial equity in a company.

Business owners, however, want to maximise their returns and having too much equity in a business makes it more difficult for them to earn a good rate of return (this rate of return is often called "return on equity" or ROE). When a company makes profits after it has paid all of the debt service costs, the profits are added to equity and increase shareholders' wealth. Some can be paid out to shareholders in the form of dividends.

A company can have a mix of traditional equity and debt investments as well as hybrid instruments, like subordinated debt, and preference shares which blend features of both (and we will discuss in more detail in Chapter 3). These all form part of its **capital structure** – the term that is used to describe the layers of financing of a company and the balance of debt and equity, as well as hybrid instruments (see Figure 3).

The investors facing the least risk will be the senior debt holders, and those facing the most risk will be ordinary shareholders. Impact investment introduces another tier of risk – grant providers who will get no financial return but catalyse the other investors by improving the risk that they face. Guarantee providers also face risk as they insure against failure of the company to deliver.

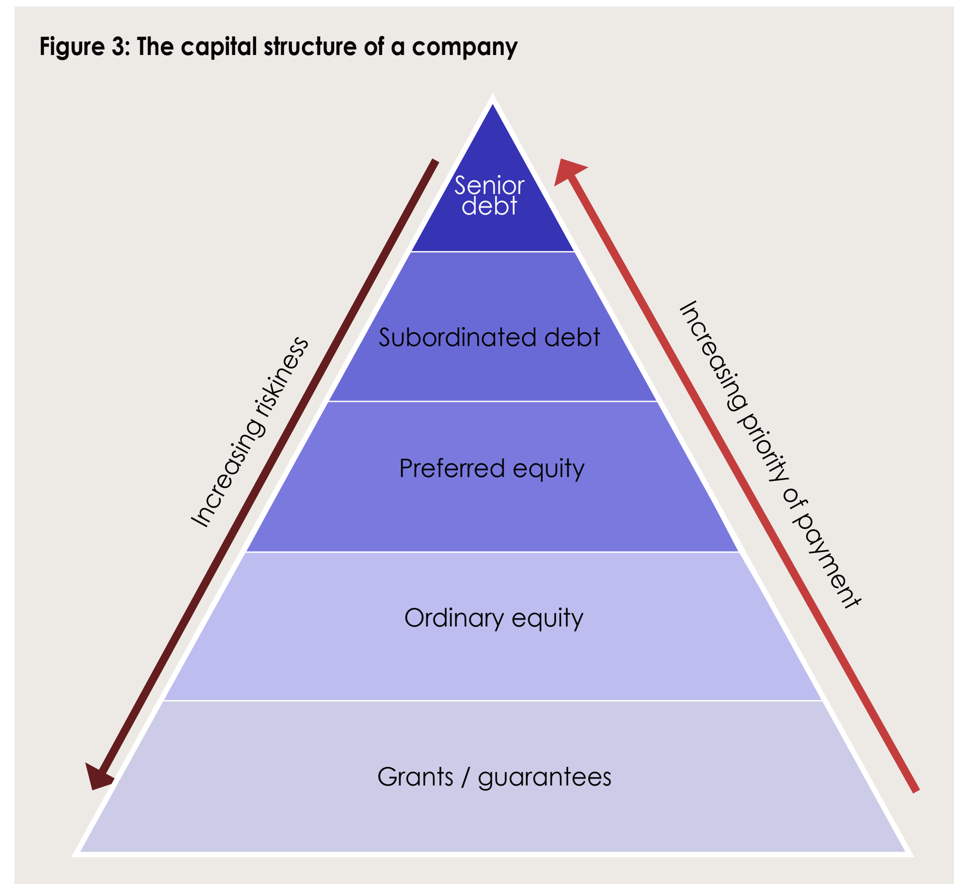
Of course, while senior debt holders face the lowest risk, they also get the

lowest return. Ordinary shareholders face the highest risk because they could get nothing, but if the company does well and is profitable, shareholders stand to gain the most. This balance between risk and return is fundamental to all investing – the more risk you take on, the higher your potential reward, but the higher your chance of losing your investment. We will return to the features of these instruments in more detail in Chapter 3.

Starting a company

When companies are set up, they need funding. This can be provided by their owners as well as lenders. Many startups are funded by owners out of savings or from friends and family. As businesses without a track record or proven business model that generates returns, lenders are likely to see them as too risky to lend to. By providing equity, the riskiness of a company is reduced because it then has money that can be used to service obligations to lenders. There are other ways to reduce risks, such as providing **guarantees**, for example a promise to settle the debt of a company if it is unable to do so, or by placing advance orders for the output of a company. These kinds of interventions are often called **"de-risking"** a company, because they make returns more predictable and therefore it is easier for lenders to provide debt to them.

Figure 3: The capital structure of a company



There are terms for different kinds of investors depending on a company's stage. The earliest investors are often called angel investors who provide funding when no one else will. They often use their own money and provide extensive mentorship. The next stage are venture capitalists, who use their investors' money, once there is a fully developed idea on the table for the company. They are high-risk investors, backing companies in the hope their ideas will become profitable, but expecting a high failure rate. Then come private equity investors who invest in established companies to help them expand. Such investors sell their interests often to larger companies who take over the business, or by listing the shares on a stock exchange. Stock exchanges are public markets for shares, though most companies' shares are held privately (we discuss the difference between private and public markets in Chapter 3).

That was a whirlwind tour of the key terms in the investment world. Impact investors use these instruments, with the addition of grants, when deciding to invest in companies that offer the promise of high impact. Those companies may be working on resolving hard social challenges, like lifting the burden of disease, or getting high quality education to children who are far from urban centres, and which, if successful, could generate a financial return alongside an impact return.

It is important to note that deal structuring and financial instruments require specific financial expertise and it is not expected that after reading this section the reader will be in a position to assess risk or determine which instruments to use. The intention is simply to provide exposure to the concepts.

When impact investing started

The term "impact investing" was introduced in 2009 to describe investments aimed at producing positive, measurable social and environmental outcomes, in addition to financial returns (Greene, 2015). The movement since has seen traditional investors working to add impact to their investment approach while philanthropies have worked to add investment to their impact programmes. Together they can produce major social change.

The predecessors of impact

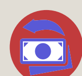
The journey for traditional investors had begun much earlier – back in the 1900s when some church-aligned investors first began what we would now see as responsible investing by excluding certain investments like alcohol companies from their portfolios. This was an early step towards a general approach of considering the non-financial consequences of investment. Over the subsequent century, several events stand out that shifted the thinking of investors and their clients about their portfolios. From the 1960s to the 1980s, activists forced many investors to disinvest through the anti-Apartheid disinvestment campaign and the anti-Vietnam war campaign. Disinvestment remains an important part of campaigns for many causes today.

But disinvesting is only a negative decision – the decision not to invest. Many of the social and environmental goals – such as those captured in the United Nations Sustainable Development Goals (SDGs) framework – cannot be achieved by avoiding investments, but by proactively choosing those which deliver the impact we want.

A TECHNICAL DEFINITION

The Global Impact Investing Network (GIIN) has created a set of four key features that define impact investing (2019):

Intentionality: The investor's intention is to have a positive social or environmental impact through investment.



Return: Impact investments are expected to generate a financial return on capital or, at minimum, a return of capital.

Range of return expectations and asset classes: Impact investments target financial returns from below market (sometimes called concessionary) to market rates and across a range of different categories of investments such as debt and equity.

Impact measurement: The hallmark of impact investing is the commitment of the investor to measure and report the social or environmental performance and progress of investments.

Foundations are already investors

Some foundations are also traditional investors, in a sense. They have endowments consisting of portfolios of investments and have the option of becoming more active in managing the impact of these investments. Many foundations have examined their endowment portfolios to ensure that their investments are not actively at odds with the mission of the foundation, for example excluding arms manufacturers or companies with poor human rights records. Some have gone further, setting aside a portion of their portfolios to actively invest in social enterprises that can deliver on their impact objectives. This portion can consist of shares and loans to unlisted companies, ranging from small startups to large, established social enterprises. These portfolios can be complementary to grant-making activity in foundations' programmes.

The practice of applying an impact strategy to the endowment is known as mission-related investing (MRI), which is led by the foundation's trustees, and often implemented with appointed asset managers.

DIFFERENT STRATEGIES BY FOUNDATIONS

Foundations can do either or both types of impact investing

- **Programme-related investments (PRIs)** are undertaken as part of a foundation's programmes alongside grant-making, such as small loans and grants to support businesses that can deliver impact aligned to the programme's objectives.
- **Mission-related investments (MRIs)** are undertaken at the endowment level and involve allocating some (rarely all) of the foundation's investment portfolio to investments that deliver impact. The impact can be aligned to the foundation's mission or be more general. This can include a component of unlisted investments directly into companies that the foundation works with at a programme-level.

Impact investing is also important at the programme level where grants are typically made. Such investments become an alternative to grant-making or complement it, aiming to increase the overall impact of a programme with a given amount of funding. This kind of impact investing is called **programme-related** investing (PRI) because it is directly connected to a programme and achieving its objectives.

››› continues on page 15

Impact Investment case study

Enterprise name:

Medical Diagnostech

Description: Medical Diagnostech (Pty) Ltd was established in 2010 as a developer and manufacturer of lateral flow rapid diagnostic test kits. The company manufactures affordable, high-quality rapid diagnostic test kits, including for alcohol consumption, drugs of abuse, HIV, malaria, pregnancy, fertility/ovulation and Covid 19.

Impact investment details: In 2013, the company received a grant of R1m from SAB Foundation through the Social Innovation Awards. In 2019, the same foundation provided Medical Diagnostech with a combination of a grant (R476,000) and an interest-free loan (R637,000). In addition, the organisation has received pure grant funding from the South African Medical Research Council and a 25% matched grant from GIZ.

Use of impact finance: Medical Diagnostech used the finance to accelerate the expansion of their operations. Specifically, the impact investment received was crucial in bringing products to commercialisation and growing the company's internal capacity. The investment enabled the team to grow from 11 to 25 people and for the company to deliver approximately 100,000 tests per month. .

Additionality: The team at Medical Diagnostech note that impact investment "helps reduce the risk relating to capital expenditure" and reports that in the absence of this investment, it would have taken them "up to 10 years to achieve the growth [they] managed to achieve within roughly two years". This is largely because the commercial funding that the company would have qualified for would have been limited and accompanied by repayment conditions that would have risked Medical Diagnostech's financial stability. Significant benefits also exist for the providers of impact finance. Providing the initial grant which enabled Medical Diagnostech to scale up its operations directly aligns to the SAB Foundation's mission of supporting innovation, job creation and social development through entrepreneurship. By further supporting the commercialisation of the organisation through the concessional lending, the foundation was able to achieve additional impact at no additional cost (as the loan will be repaid).The employment of 14 people and the production of between 50,000 and 100,000 tests per month is directly attributable to this investment.

While the investment has made it possible for hundreds of thousands of Africans to access rapid testing to diagnose and subsequently treat serious illnesses, Medical Diagnostech does not currently assess how many tests are used and how the results ultimately support health outcomes of users. The absence of robust impact monitoring and measurement (IMM) practices is a common and substantial challenge facing impact investors and is an area where foundations can provide much-needed guidance and investment.

Notes for would-be impact investors:

Medical Diagnostech's team note that an ideal impact investor is one that is willing to act as a "strategic partner", bringing valuable insights to the table alongside patient capital. In addition to being the provider of patient capital, it is important for impact investors to consider what other value they can bring to the table to support social enterprises in delivering their impact vision. For example, Medical Diagnostech has noted the need for guidance on impact measurement and reporting, and is open to receiving this guidance from impact investors requiring impact measurement and reporting as a condition of providing finance.

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There is, though, an opportunity to link MRI and PRI. This happens when a foundation decides to allocate a portion, usually a small one, of the endowment to invest into programmatic impact investing. For example, a foundation may be focused on stimulating companies that are innovating to address difficult social challenges. Such investments may be in the form of grants through their PRI, but as the beneficiaries get traction and scale, the foundation can use some of its endowment funds to buy shares in the entities to support growth. Generally, endowments have a lower risk appetite than investments made in the PRI level, because it is important to protect the value of the assets to support the foundation in the long run.

THREE EXAMPLES OF HOW GRANT-MAKING CAN BE MORE EFFECTIVE AS INVESTMENT

1: A foundation may have a programme with an objective of addressing high unemployment. It can provide grants to charities doing work to generate employment in deprived areas but could use the same money to invest in a company that is developing pioneering, labour-intensive production mechanisms. The investment may result in more jobs created than a grant, but also provide a return of the investment, which can then be used again by the foundation to achieve further impact. Or, instead of an investment, the foundation could provide a grant directly to a company to introduce a specific innovation that could lead to higher impact and potentially crowd in other investors.

2: When trying to improve education outcomes, instead of directing grant expenditure to programmes with finite beneficiaries, one could invest in a tech company that produces affordable, high-quality self-study teaching materials that results in greater educational impact. The type of investment can vary widely, from grants for companies to launch specific programmes through to general funding of social enterprises through equity and debt.

3: A foundation may manage a gender empowerment programme that aims to assist women to escape poverty by developing their skills to be able to run businesses. The foundation can complement the programme with a loan scheme that provides small loans to the entrepreneurs who have benefited from the training to assist them in establishing businesses. Such loans can be interest-free or charge lower rates of interest.

Impact investments have the potential to deliver returns across a spectrum, from less than an ordinary investment (a "below-market rate" or "concessionary" financial return) to an investment providing extra financial returns. Impact investments are channelled into companies, organisations and funds with the goal of generating both social and environmental impact along with financial gains (Global Impact Investing Network, 2023).

Given the nascent impact investing industry, there is not yet a global standard in terms of measurement and reporting on investments. Significant progress is being made, but the lack of standardisation is a key challenge facing the sector. However, many impact investors – at a minimum – use the SDGs as a key organising framework (African Alliance, 2021).

There is a wide variety of investments that can be made to generate such social and environmental returns including debt, equity, and various instruments in between. There are as many different asset classes available to impact investors as there are to traditional investors. These may range from green or sustainability bonds listed on exchanges to equity investment in social enterprises and small microfinance vehicles that provide loans to entrepreneurs. These investments can either be through passive portfolios or be actively managed by the investor. We discuss these more in Chapter 3.

The difference between traditional investing and impact investing

Traditional investing focuses primarily on maximising financial returns while managing risks. The traditional investment approach aims to build portfolios that satisfy the investment objectives spelled out in an investment policy statement (IPS), a key document that aligns the investor with the professionals who do the job of managing the investments (a foundation's trustees are usually involved in agreeing on this with the managers of the investments). The IPS can include the investor's cash requirements, for example specifying a target level of cashflows that must be provided each year. That might, for example, be cash needed for a foundation's annual budget. It can also include the investor's tolerance and ability to take on investment risk (the chance that returns will be different to those expected, including that some or all of the capital will be lost). The IPS will be implemented by one or more asset managers who will be responsible for selecting securities for a portfolio in line with the statement.

Impact investing, in contrast, involves investments made with the intention of generating positive, measurable, social or environmental impact alongside a financial return. Impact investments can target a range of returns from below market to market rate (that is, the return investors expect from an ordinary investment), depending on the investors' strategic goals (Global Endowment Management, 2022).

Historically, experts categorised investors as "impact-first" or "finance-first", reflecting which they prioritised, but in practice, many investors balance the dimensions of financial returns and impact by blending a mix of traditional and impact investments across their portfolios.

IMPACT INVESTMENT MYTHS, BUSTED

- ***Impact investing can't deliver a return on investment:*** Impact investments can be designed to make a profit and deliver impact, with studies showing that they can outperform conventional counterparts.
- ***Impact investing carries higher financial risk:*** The risks relate to the kind of instrument and its role in the capital structure, not the impact nature of the investment, although impact investors can opt to take on higher risk.
- ***Impact investing is less liquid and tougher to exit:*** While liquidity can vary, impact investments have shown profitable exits with a median internal rate of return (IRR) of about 10%, and the top one-third of deals yielding a median IRR of 34% (Goodall, 2021).

The difference between responsible investing and impact investing

While impact investing emerged in 2009, responsible investing is far older, with early practices traceable to the nineteenth century when church-run investment portfolios implemented policies to avoid investments in alcohol companies. It accelerated during the 1960s, 1970s and 1980s during the civil rights era as businesses were pressured to disinvest from the Vietnam War and Apartheid South Africa. Responsible investment became a more established professional practice in 2005 with the launch of the Principles for Responsible Investment (UNPRI) by then United Nations secretary-general Kofi Annan (Global Endowment Management, 2022). The UNPRI advocates that institutional investors sign on to six principles to signify their commitment to responsible investment, which involves incorporating environmental, social and governance (ESG) factors into investment analysis and decision-making processes.

The principles emphasise active ownership, seeking disclosure on ESG issues, promoting industry acceptance, collaboration, and reporting on progress. While responsible and impact investing both consider the social and environmental consequences of an investment, they differ in approach, with impact investing having an active social or environmental objective in addition to a financial objective (Freireich & Fulton, 2009). Responsible investing is a common theme in portfolios of listed assets, but is also extensively practiced in private equity portfolios.

Responsible investing is an early step many investors (including endowments) take as they begin to think through the impact of their portfolio. For example, some foundations that address the negative effects of alcohol through their grant-making activities, have determined it is contradictory to simultaneously hold alcohol stocks in their portfolios. Foundations can set responsible investing guidelines for their portfolio managers, for example by specifying sectors to exclude through the IPS, which sets out the mandate for the portfolio manager. This can include the full reporting guidelines of the UNPRI and selecting asset managers that are compliant with the global standard.

Impact investing, however, takes a more active approach, in which the foundation's staff and appointed advisors become directly involved in assessing investments and deciding on what to invest in. Because impact investors tend to be active stewards of investment, and opportunities to invest are focused on social entrepreneurs, investments tend to be in unlisted companies.

There are various ways the foundation can work with professional advisors, ensuring that they have access to the right skills for impact investing, but the decisions about what impact matters can be determined by the foundation to ensure that a strategy aligns with the foundation's programmes and mission *(see Chapter 2).*

"Impact investing, in contrast, involves investments made with the intention of generating positive, measurable, social or environmental impact *alongside* a financial return."

A quick look at the state of impact investing

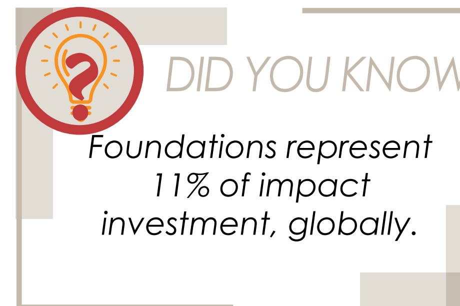
Impact investing has become a big topic worldwide. Investors and philanthropists have been directly increasing flows of money towards impact-themed investments. This is true globally, where over $1tn is being invested in impact, as well as in South Africa.

Globally

At the G8 Social Impact Investment Forum in 2013 chaired by the United Kingdom, a Social Impact Investment Taskforce was formed to catalyse the development of the social impact investment market. That taskforce led to the establishment of the Global Steering Group for Impact Investing (recently renamed GSG Impact), that has worked to advocate for impact investing worldwide. The GSG now has country partners - known as National Partners , or NPs -- in over 50 countries, including South Africa in the form of Impact Investing SA. These organisations work to catalyse impact investing along the lines of the recommendations of the original G8 taskforce.

The Global Impact Investing Network (GIIN) is another important global organisation that is fostering impact practices and works extensively with institutional investors. Established in 2009, the GIIN publishes wide-ranging research on the impact investing industry and offers tools including benchmarks and measurement approaches.

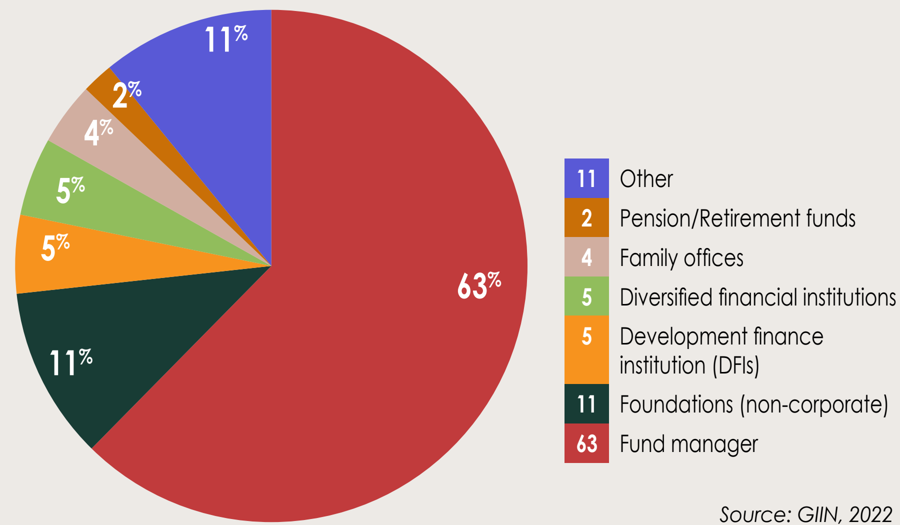
The GIIN's 2022 market sizing report estimates the current size of the global impact investing market to be $1.16tn, invested by 3,349 organisations. The GIIN research took a slice in time from a specific sample which was different to previous studies, so there is no sound basis to calculate how much this has grown, but it is notable that the GIIN's previous study in 2019 measured the size of the market at $715bn.



Foundations represent 11% of impact investment, globally.

These investors' average impact portfolio size was $485m, a figure skewed by the presence of a few large investors, while there is a long tail of much smaller impact investors. Over half of impact assets are managed in Europe (55%) with the US and Canada managing 37%. Sub-Saharan Africa accounted for 2% of the sample of impact assets. Most of these were fund managers, though the second-biggest category, with 11% of the funds, was foundations.

Figure 4: Impact investors broken down by type of organisation



Source: GIIN, 2022

The global impact investing world is increasingly dynamic and growing fast. Instruments such as green bonds and sustainability-linked notes are now common in capital markets around the world, which have use-of-proceeds restrictions to ensure that such investment is channeled to impactful objectives (we explain these kinds of instruments in Chapter 3). More and more foundations are introducing impact investing as part of their core activities, creating portfolios of assets both as integral components of their programmes, and by creating mission-aligned investment portfolios with their endowments.

Africa

Over the past five years, impact investing in Africa has grown significantly. Africa is a prime destination for capital aiming for social or environmental impact. Private equity funds targeting SMEs, public-private ventures and advisory firms have emerged across the continent, with East Africa leading in impact investing activity (Impact Investing in Africa, 2024). Countries like Rwanda have strategically fostered an enabling ecosystem for impact investing. Agriculture is a key sector for impact investing in Africa, with innovations in agritech enhancing efficiency, productivity and sustainability.

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Example: FORD FOUNDATION

In 2015 the Internal Revenue Service in the United States published guidelines for foundations, making it clear that impact investing strategies that align with a foundation's mission could still be consistent with the exercise of fiduciary duty (the responsibility to act in the best interests of the beneficiaries of an investment). This gave a green light for foundations to enter impact investing.

The then-president of the Ford Foundation, Darren Walker, engaged with trustees to persuade them to commit a portion of the foundation's endowment to impact investing strategies over a 10-year period (Hand, 2018). Walker began by noting that 95% of the foundation's financial resources were tied up in shares and bonds in its $12bn endowment that had little relationship to its core work. Apart from the non-alignment of mission, this also meant that during market downturns, the Ford Foundation's financial resources came under pressure, precisely at the time when the need was greater.

Under Walker's guidance, the foundation made the decision to commit $1bn (8%) of its endowment to impact investing over the course of a decade. The long timeline reflected the fact that there was then limited capacity to absorb significant flows of impact capital. It would take time to identify opportunities and foster the market.

Ford Foundation was well positioned to take this pioneering step. It had begun making programme-related investments (PRIs) in 1968 when it added loans, equity investments, deposits and guarantees to make a positive impact alongside its grants. These PRIs were funded out of the cashflows from its endowment, which in the US must be equivalent to at least 5% of the endowment.

The decision in 2017 added mission-related investments (MRIs) to Ford's impact activities, which then became a part of its endowment. These were at first targeted towards affordable housing and financial inclusion, which had been two of Ford's longtime programmatic focuses (Brandenburg & Iqbal, 2022), but it soon added quality jobs, diverse managers and health technology. Ford is today the largest foundation impact investor, although there are others that are larger in terms of proportion of assets allocated to impact investing.

While in Ford's view impact investing implies concessionary investments (below market rate of return), the returns on its MRI portfolio have been significant – 28% as at May 2022, five years after it started MRI, which is three times that of the endowment overall (Brandenburg & Iqbal, 2022).

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Overall, impact investing in Africa presents a promising opportunity for social and financial returns, contingent on the combined efforts of the public and private sectors. In Southern Africa, assets dedicated to one or more investing for impact (IFI) strategies have increased from US$428bn to $613bn, maintaining the region's leading position on the continent (note this figure is not comparable to GIIN's global figure as it includes ESG funds and not just impact funds). West Africa has seen its assets jump from $10bn in 2017 to $23.6bn in 2022, securing the second place, while East Africa remains stable at $18.1bn. Southern Africa has the largest amount of assets dedicated to IFI strategies, followed by Nigeria and Kenya (Riscura, 2022).

South Africa

Like many other African countries, South Africa has many daunting socioeconomic challenges, including high unemployment, poor economic growth and significant inequality. These challenges present significant opportunities for impact investment, which no doubt contributes to the recent growth of the impact investing market in the country.

South Africa's impact investing market is small but developing, and the use of non-traditional mechanisms to fund socioeconomic and environmental development is growing. With $44.36bn (~R810bn) in investments (measured by assets under management or AUM), Southern Africa has the most robust market on the continent considering impact investment strategies (Riscura, 2023). This is substantial in proportion to the R3.5tn in total AUM for collective investment schemes in South Africa in 2023 and suggests that there is a growing awareness of the need to embed social and environmental considerations when investing.

Nevertheless, there is a significant opportunity for foundations to take on a more active role in the impact investing market. Because foundations are in the unique position of being able to provide grants without expectation of financial return, they can absorb some of the risks in impact investments, enabling normal commercial investors also to invest (for example, by providing first-loss guarantees). By "de risking" an investment in this way, a social enterprise may be able to raise multiples of the funding that the foundation provides.

We identified the following strategies when engaging with philanthropic funders:

- **Grant funding:** Most foundations primarily engage in programmatic grant funding. Many have started moving beyond funding implementing partners that rely purely on grants for sustainability and have started funding social enterprises as well. Funding for social enterprises is typically

supported by some form of technical assistance and often includes follow-up support for enterprises that have promising prospects to deliver impact at scale. Some foundations are also dedicating support to fund early stage social innovation (often, but not always tech-based innovation that can address the foundation's objectives more efficiently and with greater potential for scale).

- **Loans:** Foundations offer a suite of lending instruments, from interest-free loans to loans at concessionary (below market) rates and subordinated loans. These loans help address funding gaps for social enterprises that are unable to access financing from traditional financiers such as banks or private debt funds. One foundation has established an impact investing loan fund, while others give structured loans on a case-by-case basis.
- **Endowment impact investing:** One foundation is allocating a portion of its endowment for equity investments in social enterprises with strong social impact alongside financial viability, while others have started thinking of how they can be more intentional with their endowment portfolio to allocate a proportion towards impact investing.
- **Results-based funding models:** This model, which includes social

impact bonds and outcomes funds, allows funders to buy outcomes, rather than funding activities. Put simply, result-based funding models are an alternative contracting method where payments are made only when the desired outcome is delivered. Outcomes can be jobs, CO2 reductions, maternal health indicators and anything else that can be clearly defined. Paying for outcomes is an alternative to paying for inputs like skills training that may or may not lead to the desired outcomes.

The pursuit of specific outcomes forms the basis of the contractual incentive system (GOLab, 2023). To illustrate how this funding model works, imagine hiring a gardener to tend to your garden. Traditionally, a gardener (the implementing partner) would be paid a fixed amount by a client (the funder) each month regardless of how well the garden grows. With an RBF models, the agreement is different – the two parties (the implementing partner and funder) would agree on a specific outcome, for example the number of flowers blooming or the garden being pest-free. The gardener gets paid only if the agreed upon outcomes are achieved and verified.

In the context of impact investing, investor A (the funder) will only pay for the agreed upon outcomes once they are achieved by the implementing partner and independently verified by a third party.

This approach substantially diminishes the risk of the intended impact failing to materialise, because the grant simply is not paid unless outcomes are achieved. Foundations can act as outcomes funders (effectively "buying" the outcomes) as well as investors in the social enterprises that create the outcomes.

- **Blended finance:** Some foundations have partnered with commercial investors by combining grants, debt financing (loans) and guarantees to catalyse additional capital for social enterprises. Foundations help de-risk funding models to crowd in commercial financiers.

In talking through the experience of foundations in researching this book, the themes below shone in the conversation about impact investing in South Africa.

1: **Collaboration** is a powerful force for good. Given the complexity of impact investing, it is critically important to partner with other organisations to leverage specialist skills, share learnings, co-invest and build the impact investing ecosystem..

2: The importance of **impact measurement and management (IMM)**. IMM is a cornerstone of impact investing and developing methods to measure and report on the social impact alongside financial returns is essential for foundations to embed a more intentional impact investing strategy into their broader funding approach (as we explore in detail in Chapter 4).

3: **Rethinking the role of philanthropy:** Given the huge development needs in the world, exacerbated by climate change, philanthropy can play a critical role in mobilising wider investment. By evolving from pure grant funding to strategically using funding to invest in ways that encourage more commercial investors to join in, support pilot programmes and fund innovation, philanthropy can deliver long-term, sustainable impact at a far greater scale.

Some examples of impact investing activity in South Africa include:

INSTRUMENTS	EXAMPLES	HOW IT WORKS
Results-based financing initiatives	**1. Impact Bond Innovation Fund:** A South African outcome-based financing mechanism (social impact bond) that seeks to improve early childhood learning.	Results-based financing focuses on driving greater results by crowding in impact investors to fund NPOs and social enterprises to deliver outcomes.
	2. Bonds4Jobs: A social impact bond that targets the placement of economically excluded young people into jobs.	The outcomes are paid for by an outcomes funder, often the government, which achieves the outcomes without any risk and often at lower cost than normal public procurement.
	3. Imagine Social Outcomes-Based Contract (SOBC): Also known as Imagine SIB, this is a social impact bond that attempts to address the need to intervene in the unique sexual and reproductive challenges faced by adolescent girls and young women (AGYW) in the South African context.	The key stakeholders typically include: 1) The outcomes funder, whose funding is triggered once the desired outcomes are achieved. This can be government, foundations or other development funders; 2) The implementing partners (such as NGOs or social enterprises) that receive funding from the funder once they delivers outcomes; 3) An independent verifier (such as an auditor), who confirms the delivery of outcomes by the implementation partner; and 4) An upfront funder or investor, who provides upfront financing or working capital for the implementing partners. They get their money back, plus a return, if the outcomes are achieved.
	4. Jobs Boost Outcomes Fund[1] : A R300m pay-for-performance model being piloted in South Africa. It is an outcomes fund that works with implementing partners to secure sustainable, quality jobs for unemployed, excluded youth.	The outcomes can be youth unemployment (Jobs Boost/Bonds4Jobs), having adolescent girls take PrEP and other good sexual behaviour markers (Imagine Bond), or young children achieving scores on standardised tests (Impact Bond Innovation Fund).
Impact-linked finance	Partnered with USAID and domiciled in South Africa, Linea Capital's primary aim is to provide growth capital to entrepreneurial businesses to drive revenue and job creation. It targets South African companies that are already generating some revenue and are tech-enabled. It aims for businesses that have growth and impact orientation, that create jobs and enable access for underserved communities.	The investor provides a hybrid form of investment in which repayments are a function of the investee's revenues, so companies repay only if revenues allow. In Linea's case, the investor does not use equity so as not to dilute the interest of owners of the companies it invests in.
Venture capital	Entrepreneurs for Entrepreneurs (E4E) specialises in supporting early-stage ventures in South Africa from very early stages to scale up. Targets tech-enabled businesses and focuses on supporting black and female entrepreneurship.	With this venture capital model, the investor provides financing for early-stage enterprises in the form of equity and other instruments. The investor targets highly scalable models with high return potential (at least 30% internal rate of return per investment), that have high impact potential measure on SDGs and/or diverse entrepreneurial teams.
Private Equity	Phatisa is an African private equity investor. Its objective is to raise and invest funds to feed people in sub-Saharan Africa.	This investors manages a series of private equity funds that invest in social entrepreneurs in the agri- and food-related businesses. Its funds include those providing grant funding and technical assistance to its investee companies, supporting their ability to attract private capital from other investors.

1Krutham, producers of this Handbook, is the service provider appointed to manage the Jobs Boost Outcomes Fund (formerly registered as Employment Outcomes Fund NPC). Krutham provides full administrative and financial management to the fund, manages the request for proposals and appointment of service providers, manages the performance of the implementation partners and manages the reporting to the Presidency and the National Skills Fund on behalf of the NPC.

Some examples of impact investing activity in South Africa include:

INSTRUMENTS	EXAMPLES	HOW IT WORKS
Private Debt	The Financing for Impact Fund (launched by SAB Foundation & Lead Impact Capital) is an R88m private loan fund that provides affordable financing to qualified alumni of SAB Foundation's (SABF's) entrepreneur programmes.	The investor provides loans ranging from R200 to R10m which can be used for asset and equipment financing, growth financing or purchase order and cashflow financing. Most of the underlying businesses deliver social impact beyond job creation.
Impact-first investing	Innovation Edge is an impact-first investor focused on addressing early childhood challenges in South Africa. It supports mission-aligned entrepreneurs and social innovators by de-risking early-stage product and service development.	It supports entrepreneurs and social innovators to develop, test and launch innovative solutions to early childhood challenges via offering multiple funding rounds, customising venture support and providing connections to follow-on funders. It bolsters the ecosystem by attracting new innovators, connecting diverse stakeholders and sharing insights.
Institutional	Futuregrowth Asset Management is a specialist investment company that manages a wide range of interest-bearing and developmental investments in an ethical and sustainable way.	It has a suite of development funds invested in bonds and other instruments, ranging from infrastructure to community property, development equity and agriculture. The development impact of its investments is captured in its annual impact report.

Key questions to consider from this chapter

Does your foundation team understand what impact investing is?

What skills if any would you need to bring into your team?

Could programme-related or mission-related investing help achieve your objectives?

Could the global impact investing movement provide opportunity for collaboration

forming a strategy

Beginning an impact investing strategy

An impact strategy is a roadmap that sets out a foundation's mission and purpose and how to achieve a desired impact. It spells out intentions, and the practical steps to take. Within this impact strategy, investment may be one of the tools to be used, but it can sit alongside other tools like traditional grant-making and funding research and innovation. Some foundations already have a clear articulation of their objectives, which they may describe as a mission and vision. An impact investing strategy adds to this tool kit by allowing for investments that help deliver these objectives.

The move from grant-making to impact investing requires a deliberate effort to evolve a foundation's strategy. Foundations need to spend time thinking through their impact objectives, along with the internal resources available to support impact investing. This chapter provides an overview of best practice principles for designing an impact strategy through six key questions. We introduce more detail from the traditional investing world on how to think about returns and risk, alongside impact. With the answers to these questions, you will have the basics of an impact investing policy. The chapter concludes with a practical guide to follow in developing an impact strategy for a foundation.

Best practice principles

To start, we've set out four key principles drawn from engagements with foundations that have walked the impact investing journey.

- **Have a case-by-case approach.** Impact strategies are varied and need to reflect the unique nature of the foundation itself. History, mission and vision, existing internal structures and available people to support impact investing will all play a role in deciding how a foundation grant-maker can also become an impact investor.
- **Make it a collaborative effort.** Translating a foundation's mission into an investment strategy should involve robust engagement with several key stakeholders, including the board, funders, beneficiaries and even regulators. Often, this involves a degree of education on impact investment as a concept and its relevance for the foundation.
- **Be prepared for some changes to internal structures.** It is often necessary to make structural shifts internally, particularly with respect to governance, to ensure that the strategy can be effectively implemented. Impact investment requires different forms of oversight and decision-making than usual grant programmes.
- **It takes time.** Introducing impact investment cannot happen overnight, and often requires an iterative journey. Board and committee approvals may involve multiple discussions. Even once a strategy is determined, it can take a long time to identify investment opportunities that fit the strategy.

In our experience, foundations begin their impact investing journey from one of two perspectives: as an addition to their existing grant-making programmes, as the SAB Foundation has done, or as a shift in approach

for their endowment, as many international foundations such as Ford Foundation, have done. Some do both at the same time or expand from one to the other as they build experience in either. Foundations can follow any of these routes, depending on their existing activities and competencies. For example, a foundation whose existing programmes would be easily complemented by impact investments like loans, or grants and technical assistance to social enterprises, may find it easiest to begin with impact investing by adding investment instruments to the tools they deploy in their programmes. This can include grants or other concessionary funding to invest in innovation to help in scaling their impact, for example health or education technology.

Alternatively, foundations can start by considering their endowments and whether they can introduce mission-related investments into their portfolios. This approach can allow for larger scale if the endowment is large but tends to be more risk averse given that foundations depend on their endowments and the returns they generate to fund their work.

Example: PERSISTENCE PAYS OFF

Many foundations report that their teams persisted for a long time, often several years, to secure buy-in from leadership bodies (particularly boards) to explore impact investment.

The team at the **SAB Foundation** presented impact investment as a means to ensure the achievement of the foundation's objective of supporting social innovation, as grant funding was enabling social enterprises to travel only part of the way along the journey. Over time, the SABF went from providing grants only, to providing equity investments, interest-free loans and eventually concessionary loans as a way of supporting social entrepreneurs to achieve scale. This enabled greater social innovation – evidence of the value that impact investment can add to a foundation's core mission.

For the **Makwande Empowerment Trust,** impact investing presents an opportunity to further the foundation's mission of empowering black women and youth. Discussions with the board have focused on unpacking impact investment principles, as board members have limited experience with the concept and its applicability to the foundation's mandate. At the time of writing, impact investment was being integrated into the foundation's investment policy after extensive discussions with leadership and staff.

This graphic summarises the steps to follow in developing an impact investing strategy for a foundation. The rest of the handbook provides the detail.

What type of impact investing will the foundation pursue?

PATH A: Mission-related Investing

1. Does the foundation have a clear mission statement

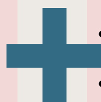
YES → **Develop impact investing strategy**
- Define strategic impact objectives
- Develop IMM framework
- Develop theory of change an impact thesis

NO → **Develop a mission statement** → Develop impact investing strategy

2. Determine which instruments can be used to execute the impact investing strategy
Debt, equity, hybrid, listed vs. unlisted etc.

3. What is the amount available from the endowment for impact investments?

Proportion of overall endowment
- **1%-5% > Explanatory Phase:** small allocation to identify and assess potential opportunities
- **5%-15% > Maturation phase:** Nurturing the growth pf the portfolio by developing and refining endowment strategy
- **>15% > Embedded phase:** Fully integrate impact investing into the endowment thesis



Criteria for investment amount
- **High (1mn+)>**Research and identify potential investments
- **Moderate (R500k-1m)** >Focus on specific sectors
- **Low (Under R500k)>** Consider partnerships with other investors

4. Incorporate impact investing strategy into IPS

5. Will the management be outsourced

YES → Select investment manager on criteria

NO → Select dedicated internal team to manage in-house

6. Identify potential investments, programmes or impact investing initiatives to support

7. Conduct due diligence on identified investments
Assessment risk, return, and impact potential

8. Make investment decisions
Invest in chosen opportunities

9. Monitoring, evaluation, reporting and learning
- Performance assessment against mission outcomes
- Impact reporting
- Research and learning for future investments

PATH B: Programme-related Investing

1. What proportion of the budget can be ringfenced for impact investing activities

Proportion of overall budget
- **1%-5% > Exploratory phase:** Small allocation to identify and assess potential opportunities
- **5%-15% > Maturation phase:** Nurturing the growth of the portfolio by developing and refining strategy
- **>15% > Embedded phase:** Fully integrate impact investing into the endowment

YES → **Develop impact investing strategy**
- Define strategic impact objectives
- Develop IMM framework
- Develop theory of change and impact thesis

NO → **Develop a mission statement** → Develop impact investing strategy

3. Set criteria for selecting programme-related investments

Investment Criteria
1) The **impact** the foundation wants to receive
2) Type of **impact capital** the foundation wants to provide, for example catalytic capital in the form of technical assistance, guarantees or other blended finance structure, direct equity investments, loans etc.
3) **Community engagement** required to maximise impact
4) Long-term **sustainability**

4. Identify potential investments, programs or impact investing initiatives to support

5. Conduct due diligence
Examine feasibility, cost-effectiveness, as well as risk, return and impact. Bring in outside expertise to assist where required.

6. Make funding decisions
Invest in selected programmes

7. Monitoring, evaluation, reporting and learning
- Performance assessment against mission outcomes
- Impact reporting
- Research and learning for future investments

Key questions to answer about investing as a foundation

In the rest of this chapter, we work through six key questions that we think are important for foundations to think through. These are practical questions which will set out the key features of your impact investing approach. We start with these to set some foundations on which to build your impact investing strategy.

1. How much do I want to invest?

Foundations should decide how much to dedicate towards impact investment.

This can be at the level of programmes (PRIs), as well as at the level of the endowment (MRIs). For PRIs, the allocation is often expressed as a percentage of annual programme grant-making. For example, a foundation may say it wants to redirect 20% of its annual grant budget toward impact investment instruments and set a timeline of three years to reach the target. The target to set will depend on the details of the programmes and objectives a foundation has. If impact investments will improve overall programme performance, then a larger allocation would make sense, whereas if the strategy needs to be tested to establish its effectiveness, a smaller allocation would be appropriate.

In the case of MRIs, we've seen several foundations start with a target of 5% of an endowment to be allocated towards impact investing as a first goal, phased in over time. A study by Bridgespan Social Impact (2024) found that in the United States the median foundation allocates 5% of its endowment assets to impact investment, although smaller foundations generally allocate a higher percentage, some more than 50%. Others, though, start as small as possible, say 1% of a portfolio. The appropriate target will depend on the size of the foundation's endowment. A smaller foundation may need to allocate higher proportions to ensure there is sufficient scale for investment. This is important because there are certain fixed costs, such as having lawyers draw up loan agreements, that require scale to justify. There is little point in incurring legal fees if you are only going to make one or two small loans.

WHERE CAN I GET HELP?

Your impact investing journey doesn't need to be walked alone. There are several sources of support, both informal and formal.

Various networks of impact investors can provide help. Impact Investing SA, for example, has a foundations working group which works together to improve the impact ecosystem (and commissioned this handbook). There are also various consultants that can support you.

Usually, foundations need support with the financial concepts and vehicles to realise their objectives. Financial advisors and consultants are able to assist, though it is important to determine how much impact experience they have. When considering a consultant, get references from previous clients. If the advisor is going to manage investments on your behalf, or give specific investment advice on what to invest in, they should also be registered with the Financial Services Conduct Authority.

If you are going to make investments directly, you should seek legal advice to draw up agreements. Most commercial law firms can help, though it would be preferable to work with one that has specific impact investment experience.

Many foundations start small and then scale as they learn. Another good way to start small and learn is to co-invest with other like-minded foundations that are also exploring impact investment approaches. This allows foundations to share knowledge as well as risk while taking a smaller exposure. It may also be a good way of fostering social enterprises, if they perceive a good pipeline of potential funders, they will take steps to build their businesses and investment opportunities. On the flip side, dedicating only a small tranche may limit the ability of the portfolio to achieve financial return and impact at the scale required to convince stakeholders of the value of the impact investment model.

Foundations must be concerned about risk (which we return to for question 3, below). At an endowment level, this is the risk of losing money on investments. Foundation trustees have a responsibility to ensure that investments are managed prudently, and this responsibility means that due care must be taken to protect the value of the endowment and ensure that it generates appropriate returns for the risks it is willing to take. This generally means initial allocations to impact should be small, growing over time as the risk features of such impact investments become clear.

In the case of PRIs, the risks are different, as the grant-making programmes will deploy the money whether it is into return-generating assets or not. This means that PRIs can face higher financial risk if such investments fail, the loss is equivalent to what would have been spent on grants. This risk feature of PRIs means they can be easier to start an impact investing strategy with, and then graduate such investments into the endowment after they have proven themselves. However, PRIs may be able to tolerate higher financial risk, but they face higher impact risk. The alternative to a PRI is a grant that could have a much more certain impact. At the MRI level, the risk concerns focus on the financial downside, but at a PRI level, the risks are to the impact downside.

For example, consider a foundation focused on secondary education. In your normal programmes, which may include scholarships for promising students, you know exactly what outcomes to expect. However, as an alternative you could invest in a social enterprise that offers technology giving students access to all past papers and teaching by a pre-recorded teacher at a cost that is significantly more affordable than a tutor. Instead of the narrow number of students supported through your current programmes, by backing the enterprise, you could potentially enable many more students to achieve their qualifications. However, the company is new and it is unclear whether people will be willing to pay for it yet. From an impact point of view, the potential could be significant, but there is still much to test, and there are considerable risks. If this business already had thousands of paying customers, then there would be more evidence of impact as well as financial performance. We discuss the impact risks to analyse in more detail in *Chapter 4*.

In traditional investing, investors focus on risk and return. Impact investors add a third dimension of impact to assess in making decisions about what to invest in. In the next set of questions, we consider the way traditional investors think about return and risk and add impact as a third dimension alongside the first two. We will analyse impact in more detail in Chapter 4.

2. What level of return do I need?

Investors generally talk of **"required return"**. This is the amount the investment must pay us, usually expressed as a percentage, to take the risk of investing.

A key idea in investing is that the return should compensate for the risk (which we discuss more in the next question). If you were depositing your money in a big bank, you'd be confident you'd get the money back and the bank would be able to pay you the interest it promises, so you'd accept a lower return. But if you were investing in a mining exploration company that is prospecting for gold, you'd not be sure whether it will strike gold and create big profits. For you to choose the exploration investment over the bank deposit, you must believe the potential returns are high enough to justify the risk.

In practice, investors analyse opportunities by trying to estimate the future cash flows they will get. A bank deposit is pretty easy to estimate, though you can still face risk from fluctuating interest rates. Other kinds of investments can be hard to predict how the investment will work out (more about risk next).

A foundation can assess what kind of target return it desires and express this either in absolute terms (a set percentage such as 10%) or in relative terms against some benchmark (eg the consumer price index [CPI], a measure of consumer price inflation, plus 5%, which would allow the portfolio to cover the effects of inflation and earn 5% on top of that). This is usually the approach to creating an investment plan for the endowment but can also be applied at the programme level to determine investment approaches and set return expectations for programmes. Foundations can set return expectations for their impact portfolios that are "concessional", in other words, below the rates that commercial investors would expect. We will explore the options for concessional finance in the next chapter on impact investment vehicles.

When undertaking programmatic investments, you may not require a return at all but see a return as an upside to support future spending. This can change over time, especially if you build a portfolio or set of standardised products at a programme level that

PURPOSEFUL PARTNERSHIPS

In cases where impact assets are limited or constrained, it may be in the best interest of a foundation to consider co-investment. This involves investing in impact projects alongside other foundations, the public sector or commercial investors.

Foundations such as the **DG Murray Trust**, which dedicates 1% of its endowment to impact investment, and **Mastercard Foundation**, have intentionally embedded collaboration into their impact investment strategies. This enables risk sharing and increases the pool of funding available for investment, which maximises potential for achieving impact at scale.

"The rootedness of a local foundation in a country of the South enables sustained, context-sensitive co-investing by foundations based in other countries – and, we would argue, greatly enhances the expected benefit of such co-investment. For this reason, DGMT actively seeks co-investment in trying to achieve its strategic objectives." (DGMT five-year strategy, 2023-2027)

"We are engaging with government, public sector institutions, businesses and the private sector. These partners have the capacity to deliver tangible benefits for young women and men, and potential for achieving transformational change at scale." (Mastercard Foundation Africa Growth Fund Impact Strategy)

Through their involvement in blended finance vehicles (see Chapter 3), particularly social impact bonds (SIBs), foundations like **Standard Bank Tutuwa Community Foundation** act as co-investors alongside commercial investors to catalyse impact through results-based finance.

you can attach return expectations to. It is, however, important at the endowment level to have return expectations. This should match objectives – some social enterprises require long-term patient investment that will help nurture them without pressure to deliver returns.

There are several issues to consider in setting a return requirement:

- **Spending rate.** How much does your foundation want to spend, as a percentage of the assets being invested? For example, a spending rate of 5% of the value of assets is common.
- **Inflation adjustment.** If your aim is to protect the long-term purchasing power of your portfolio, it is important that the returns cover the effects of inflation.
- **Cash needs.** This speaks more to the time horizon for your investments than the return but is important to consider when designing a wider investment strategy. If your portfolio must deliver a certain amount of cash to fund programmes, investments should be chosen that mature at the right time and pay out cash with sufficient certainty.

The spending rate can be calibrated against expected returns. For example, the JSE Top 40 Index (a commonly used portfolio of the biggest 40 companies listed on the JSE) has yielded an average return of 9.4% per year over the last five years. Meanwhile, core inflation has averaged 4% over the same period. So the "real" return, that over and above what is required to maintain the value of the portfolio after inflation, was 5.4%.

Collectively these considerations set the **required return** that the portfolio must deliver. The task then is to select securities such that the portfolio as a whole will cover this requirement. This is usually done by utilising a professional investment manager or an asset consultant.

The required return for an endowment may be less than the expected return. In other words, the return you need to maintain the value after inflation and cover spending needs may be less than what the portfolio can reasonably be expected to return. This effectively means you have some "excess return" that could be used to make much more risky investments. Some foundations have created an impact strategy by assuming the small tranche they allocate to impact assets will not yield a return, which can be covered by the excess return from the rest of the portfolio. This is a comfortable approach that doesn't risk the main spending of the foundation, and if it does yield a return, this can be factored into future plans. Of course, not many foundations will be in this position – expected returns may only just cover spending needs.

3. How much risk will I tolerate?

Risk is usually assessed by investors in terms of probabilities, ie, the likelihood that an investment will perform as expected. When investors lend to risky borrowers, they use tools such as credit ratings, which indicate the probability that the borrower will default and not be able to make repayments. When it comes to investing in companies, risk is assessed as the probability that the company will generate the profit it expects and the dividends that will be paid to investors. Investors aim to ensure that the returns that they expect justify the risk. For example, a bank deposit that pays 10% would be seen as equivalent to an investment that may pay 20% but only with a 50% probability (ie, the risk-adjusted return is 10% because you have an even chance of getting 0 or 20%). When investors talk of **"risk-adjusted return"** they mean the amount of return they can expect after factoring in the risks in this way. When it comes to shares in a company listed on a stock exchange, investors generally look at how much the share price tends to move over time. High-risk companies see big swings in share prices, because their prospects can shift dramatically quite quickly. These swings can be up or down, and in finance investors generally see these the same way: share price swings (or "volatility") are an indication of how hard it is to predict returns, and therefore how risky those predictions are. The same principle applies to unlisted shares, but analysts assess risk by directly looking at how variable cash flows are and sometimes use the share prices of companies in similar industries as a proxy. Generally, it is this risk-adjusted return that is set as the expected return for the endowment.

Remember that if investing were an exact science, people would know exactly which shares to invest in on the stock exchange and how much to invest to make the largest amount of money. There are many things that can influence performance. For example, a retail company could have a bad trading quarter or there could be a major shock such as the Covid-19 pandemic where there is no trading, both negatively affecting the value of the shares. Some important things to consider when thinking about risk are how a company will be affected by the economy, what the likely future demand for the business's products will be, and how much competition the company faces. All these considerations help to partially understand the risk.

The riskiest businesses are those where there is no trading history. For example, say someone has developed technology that can instantly assess lungs for tuberculosis. TB causes 1.2 million deaths globally each year. An instant diagnosis can prevent the spread of TB. However, since the business isn't operating yet, it's difficult

to predict how much money it will make so if you invest in it, you are taking a lot of risk. If the technology is bought by health care facilities across the world for TB detection, you will make a substantial return. There is no silver bullet when assessing risk, however there are many skilled individuals that can analyse risk at both the very early stages as well as more mature businesses who can help.

Investors manage risk by ensuring they have a portfolio of investments that spreads the risk, the old adage not to put all your eggs in one basket. A portfolio ensures that if there is a negative outcome on one investment, the others in the portfolio balance it out. A portfolio approach allows investors to tolerate risk at the individual investment level, but they should think about how similar the investments in a portfolio are to determine how spread such risk really is. It is not just the number of investments, but how diverse they are that enables an investment to spread risk. For example, a portfolio of companies that are all in information technology will be riskier than a portfolio that has companies in IT, biotech and agriculture.

Investment analysts distinguish between **risk ability** and **risk tolerance.** Risk ability refers to the objective features of an investor that influence the amount of risk they can take. Risk tolerance refers to a qualitative, psychological, willingness to bear risk. Some investors are highly risk averse and want to avoid any risk that an investment may lose value. That may be the case even if, objectively, they could afford to take significant risk. Usually, a board of trustees will set the risk tolerance for a foundation, in consultation with investment advisors.

Many kinds of investors have risk abilities that are affected by their different investment objectives. A pension fund, for example, must ensure its members are able to retire and afford to live well. A bank must look after the public's savings, so must be very cautious in how it lends it out, making only low-risk loans.

The factors listed below are important in determining risk ability and could be used in deciding how much risk a foundation is able to bear:

Factor	How it influences risk ability
Time horizon	The longer the investor can put money away for, the better they can handle short-term fluctuations in a portfolio's value. Foundations often have an endowment that should endure in perpetuity, so the time horizon is very long, suggesting this factor gives foundations a high-risk ability. A time horizon can also be influenced by the foundation's overall impact strategy. If the aim is to have an impact on very long-term challenges, like reforming the education system, there may need to be a long time horizon to enable investments that could have this impact.
Spending needs	In contrast, foundations can, have spending needs in the short term that must be met, requiring more stable investments that can be relied on to deliver cash at the right time. If there is flexibility in future spending needs, budgets can be adjusted downward if returns in one year are poor, then the foundation has a higher risk ability.
Size of portfolio	The larger the portfolio, the better the capacity to diversify and absorb potential losses. Smaller endowments may not be able to diversify sufficiently, leaving larger parts of their portfolios exposed to individual securities. The extent of appropriate diversification depends on the costs related to investing – transaction costs may average higher if the portfolio is small.

These factors can be considered in thinking through the risk ability of a foundation, which may help decide what the foundation's risk tolerance is. The risk tolerance is important in formulating the strategy and deciding what types of investments are going to be eligible under the strategy – lower risk debt instruments or higher risk unlisted equity, for example.

4. How do I balance risk, return and impact?

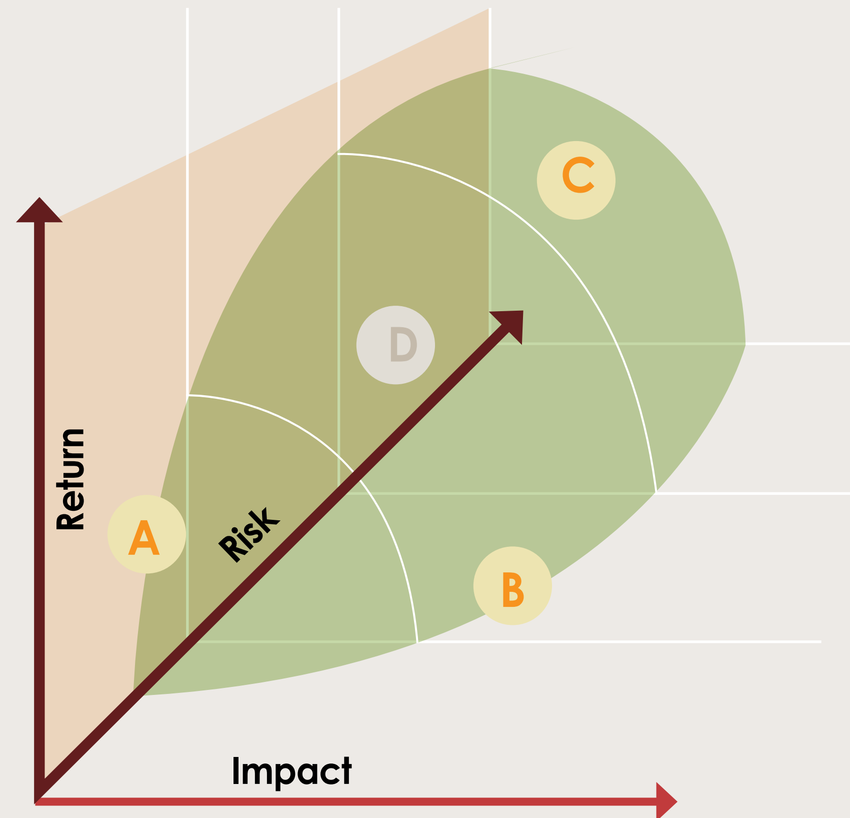
For impact investing, an important further element to consider is the expected impact that the investment should have. This must also be analysed, and the risks to this impact also be factored into the investment case. In Chapter 4 we explore impact measurement and management in more detail. Impact is a third dimension to assess, and therefore impact investors often talk of the investment decision as being about **risk/return/impact**. These can be analysed jointly so that impact investors find the right balance between them to fit their strategies. Some may be willing to sacrifice financial return or accept higher risk, if the investment has a very high impact. Note that impact also has risk –the investment may fail to deliver the impact that was expected. It is important to factor this into the risk analysis, too, and we set out different approaches to impact risk in Chapter 4.

There is no scientific answer to determine how you balance these factors. It should be the outcome of a stakeholder process, assessing what the priorities for your foundation are.

One way to think about the three risk/return/impact vectors is as an "efficient frontier", a concept borrowed from traditional investment theory in respect of risk and return. See the box below for details.

Foundations can get help to think through these different considerations to form their impact strategies from investment advisors that have a specific impact capability.

Figure 5: Graphing the risk/return/impact vectors



A risk/return/impact approach to assessing investments considers the three aspects of impact investment together. Any investment can be assessed on expected risk, expected returns and expected impact. "Efficient" investments are those which cannot be improved without sacrificing something – either impact, return or by increasing risk. These investments are those that sit at the "efficient frontier" depicted in the three-dimensional graph in Figure 5. Everything within the bubble and on the surface are theoretically possible investments, but only those on the surface of the bubble are "efficient".

To see how to think about the risk/return/impact trade-off, consider four investments marked in Figure 4:

A Is an investment that is relatively low risk and low return, but has no impact features. This might be a traditional low risk investment like a bank deposit.

B Is an investment that moves further out the impact vector, but has zero financial return. Such an investment might be a traditional philanthropic grant that receives no financial return. It still has risk, which is the risk that the expected impact does not materialise.

C Is an investment that presents both higher return and higher impact than A, but only by taking on much higher risk. Such an investment might be investing in a medical innovation that may well deliver high return and impact but may also fail at testing point.

D Is an investment that lies below the efficient frontier. This provides the same return as A, but at much higher risk, and the same risk as C but with lower impact and lower return. In every way C would be a more efficient investment than D, given it offers better returns and impact at the same level of risk.

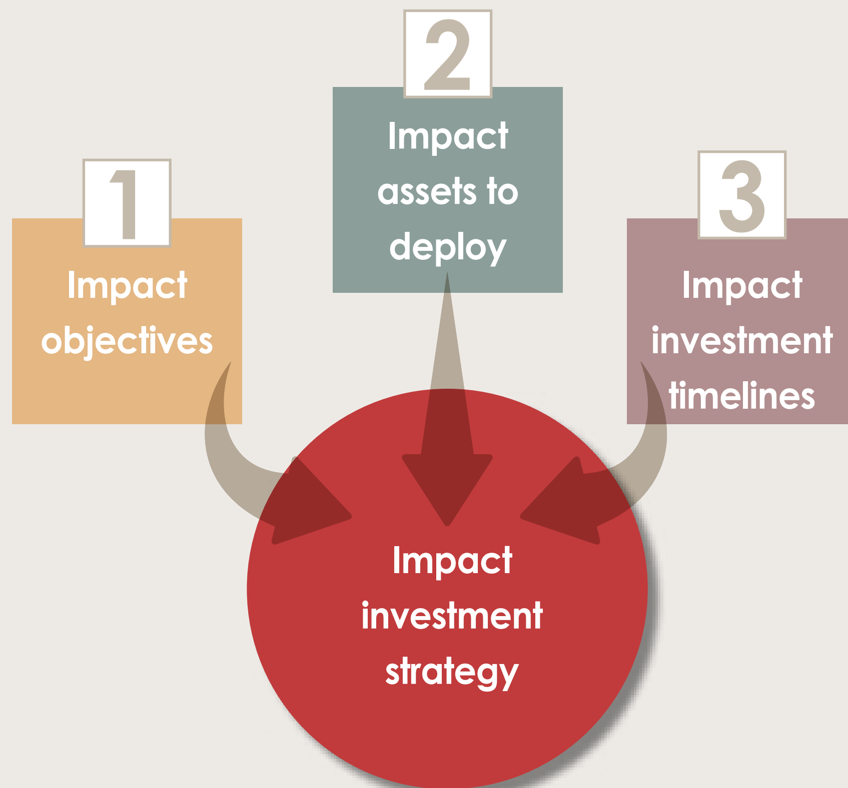
Risk/return/impact shows how these three criteria can be traded off against each other. It suggests that return and impact are in tension – if you are going to increase impact, you can keep returns steady but only by increasing risk. A foundation should determine where on the efficient frontier it wants to invest, and aim to build efficient portfolios.

Note: this remains a conceptual framework that offers investors a way to think about impact and financial performance in an integrated way. What its implementation looks like in practice will vary.

Practical next steps

The above questions should give a sense of how to balance risk, return and impact in forming your impact investing strategy. In the next two chapters, you will learn how to refine these into a concrete plan. In the remainder of this chapter, we work through a broad approach to setting up your impact investing strategy with two more questions to answer.

An impact strategy can be framed in terms of three concepts:



5. What are my impact objectives?

A foundation likely already has a set of objectives, defined in terms of its mission and vision. These can form the basis for setting impact objectives. It can be framed in similar terms to a foundation's existing strategies but with a clear description of how impact will be measured. As we will discuss in Chapter 4, a critical element in impact investment is the measurement and management of impact. Objectives should be framed such that their achievement can be tracked by gathering evidence. A good objective, for example, would be "to create 10,000 new jobs", because it is clear what success looks like.

6. What kinds of impact investment will I undertake?

Investments that can be made by the foundation include grants or technical assistance, as well as more traditional investments such as loans and shares. A strategy should set out what types of organisations a strategy will support and what the form of this support will be. For example, a foundation might decide it is not comfortable making equity investments but is comfortable making small loans to beneficiaries of its programmes. The strategy will specify the terms of these loans including whether they will charge interest or make interest-free loans (or a concessional rate in between) and the repayment arrangements, including when loans will be written off if they are not repaid. This is discussed further in *Chapter 3.*

Impact investment timelines are the length of time investments will be made over and how long the investment will be deployed. A strategy can set out, for example, how long a foundation would like to be invested in a social enterprise for, or the tenure of the loans it provides (length of time until repayment). Being clear about timelines gives you clarity on how far your money can go because you know when you will be getting money back from investees you can then redeploy. It also informs the types of assets that a foundation will deploy. Equity investment tends to be long-term as companies need to be able to grow before it is feasible to sell their shares to new investors. A typical private equity fund will expect to invest for five to seven years. Loans can be short (a year or less) or long-term (five to 10 years), depending on the objectives and types of borrowers.

Incorporating impact into the investment policy statement

With the above questions answered, you are well on your way to formulating an impact investment strategy for your foundation.

A critical next step is to articulate the answers to these questions in a document. This sets out in writing your foundation's views on the above questions. This document becomes a guiding light for your impact investing strategy that is shared among all those working on it.

In the case of your endowment portfolio, there is a standard document that governs all of the investing done with the portfolio called an **investment policy statement** (IPS). This is a document that sets out the foundation's investment objectives (what it aims to achieve) and the principles according to which it aims to achieve these. Generally, the IPS is focused on the investment strategy for the endowment, but it can include the strategy for investment at a programmatic level too, as well as guardrails for how the endowment could provide funding that is aligned to programmes (such as loans for programme beneficiaries or investments into social enterprises). The IPS is typically developed together with your financial advisors and asset managers, so it is a jointly developed document, though a foundation's trustees have the ultimate authority for it.

The policy acts as a clear reference document for asset managers and other service providers. Typically, the IPS will include guidance to asset managers on issues such as:

- **Asset allocation** – what broad classes of assets like shares, bonds, private equity and so on, can be invested in across sectors and geographies, and how much can be invested in each.
- **Investment decisions** – setting out how decisions should be made, including clear risk, return and impact criteria.
- **Stewardship activities** – how asset managers should engage with investee companies to influence their behaviour including engagement with underlying investments on improving financial and impact returns.
- **Reporting** – both by investees and by service providers to the foundation itself.

The IPS is an opportunity for foundations to codify their mission or purpose, their investment beliefs and strategy and the governance structures in place to guide investment activities.

Foundations that are currently investing in an endowment will likely already have an IPS. The first key step in introducing impact investing is to adjust the IPS's objectives to incorporate impact investing. The existing IPS will specify several objectives, including setting performance benchmarks for the portfolio, risk tolerance (including asset allocation guidelines), time horizons and liquidity needs. It will also typically set out various governance features of the investment strategy including which decisions are reserved for the board of trustees and which decisions are assigned to asset managers and consultants. To this, impact investing objectives can be integrated, or an impact investing policy added to the

IPS specifically to govern a tranche of the overall portfolio set aside for impact investing.

While typically the IPS governs the relationship between a foundation and its investment service providers, it is important to consider a wider audience and their needs.

There are several components that foundations can choose to include in their investment policies. These will vary depending on the organisation's level of impact investment experience, its mandate, and whether the IPS is a sweeping document or one document in a broader suite of policies and statements. The answers to the six questions asked above can form the bulk of the IPS. Other content might include:

> "The answers to the six questions asked above can form the bulk of the IPS."

- An **introduction** to provide context around how a policy was developed, its governance, purpose, scope and the beliefs and objectives, as well as the stakeholder, client, or beneficiary needs that underpin it;
- A section which sets out a foundation's **impact objectives and priorities** and outlines how the organisation wants to contribute to creating impact (this can reflect a "theory of change" which we discuss more in Chapter 4);
- **Clear investment guidelines** describing how impact considerations should be incorporated within investment processes (including any expectations around stewardship), any exclusion requirements and also any specific targets for financial return and impact that are to be achieved, along with applicable timelines;
- An **overview of governance** structures applicable to the policy's design and implementation; and
- The **traditional investment features** of an IPS must also be covered to govern the balance of the portfolio that will continue to be invested, including risk and return objectives, asset allocations, benchmarks, liquidity needs, and so on.

An organisation's impact investment policy should be considered a living document which is designed to evolve in response to changing circumstances and regular review.

Example: IPSs FOR FOUNDATIONS

The US-based **McKnight Foundation's** IPS includes guidance for managers of mission-aligned investments, high-impact investments and programme-related investments, as well as the traditional features of benchmarks, target asset allocations and spending requirements. These are integrated into its wider IPS that also includes traditional principles for the management of its $2.5bn endowment. *See the IPS here.*

The $450m **McConnell Foundation,** a family foundation in Canada, has a 10% allocation of its endowment to impact investments. It has created an impact investing policy statement covering both MRIs and PRIs as an appendix to its more traditional IPS. *See it here.*

The $1.3bn **Rockefeller Brothers Fund's** IPS includes policies ensuring all investment allocations across the portfolio reflect the mission of the foundation. This includes exclusions of investments such as fossil fuels and it outlines its impact investing objectives through private equity and debt, real estate and infrastructure that further the fund's mission to advance social change that contributes to a just, sustainable and peaceful world. *See its IPS here.*

The $318m **Heron Foundation** was among the first to engage in MRI, back in 1997 when it took the then-unprecedented decision to allocate 40% of its assets to support its mission. This increased to 100% in 2012. Its IPS declares that "all investment is impact investment" and, unusually, also includes grants within the ambit of the statement. *See its IPS here.*

The **Government Employees Pension Fund,** the biggest pension fund in South Africa, has a Development Investment Policy (which is an impact investment strategy of a sort). *See it here.*

The IPS of the **Woodcock Foundation,** a US-based foundation that makes grants of $3.5m per year, is constructed much along the lines of the approach discussed in this chapter. *See it here.*

The **Esmeé Fairbairn Foundation**, a £1.3bn UK-based foundation, has impact incorporated into its IPS. *See it here.*

It is not only large foundations that have incorporated impact into their polices. The **Treebeard Trust** in the UK has allocated 30% of its £13.1m endowment to impact investments and has built up a considerable portfolio of impactful private equity investments, having started only in 2011. *See more here.*

Getting the people right – who does what?

To get an impact strategy up and running, you will need both the financial resources and the right kind of people on board to do it in your foundation. It is critical to have clearly identified who is leading the process and what each party's responsibilities are. The impact strategy may be driven by a full-time employee or a champion at the board or investment committee level, or the responsibilities can be assigned to an existing team member by adjusting the member's role to incorporate the impact investment mandate. It is often the case, especially at first before an impact strategy has proven its value, that foundations use existing resources to start their strategies.

Often, foundations need to supplement their own capabilities with external experts to provide specialist input. These can be financial advisors or specialist impact investing advisors. In choosing such advisors, it is important to undertake some due diligence, including checking if they are registered with the Financial Sector Conduct Authority to be able to provide financial advice, and obtaining references from other clients. Financial expertise can be expensive, so you will need to find someone who can support you within your budget.

While there is no single "right" way to resource the impact investment function, in general, these three options are useful in developing capacity for the transition to impact investing:

- **Adapt** existing roles to include an authority to lead the design or implementation of an impact investing strategy. This strategy is most appropriate in cases where the technical capacity to fulfil the impact investment transition mandate exists in-house or where resources are not available to recruit additional staff.
- **Create** a new role within the organisation to deliver an impact investing transition. This approach is well suited to foundations that do not have in-house technical capacity to implement the transition strategy or where resources are available to grow the impact investment team.
- **Outsource** the design or implementation of the impact investment strategy to a third-party contractor. This may be particularly relevant where the nature of the strategy is especially focused and requires specialist input, or where the option to adapt or create internal roles is deemed inappropriate.

Outsourcing presents an opportunity to maximise efficiency and enables access to expertise. Outsourcing can also reduce operational costs compared with maintaining an in-house team, and it allows for efficiencies in scalability as foundations extend impact by leveraging external partners. Outsourcing specialist functions also enables a foundation's internal team to focus on its core competencies and to concentrate on itsstrategic priorities. On the downside, outsourcing can create dependency on external partners and may limit strategic flexibility and increase the need for resourcing dedicated to ensuring accountability (Buia et al., 2018).

Developing capacity internally offers the opportunity for greater alignment with the foundation's mission and values, direct control over investments and impact outcomes and the ability to build internal capabilities and foster innovation. This approach is often accompanied by higher upfront costs and tends to require more time to realise financial returns (Beers, 2024).

In our research for this guide, we found that South African foundations that already apply impact investing generally have only a small internal team dedicated to it. In many cases, impact investment is the responsibility of a single individual. As such, the use of external advisors is not uncommon and can often be used to develop the first investments which can demonstrate the value in further internal capacity.

As part of the introduction of impact investing, it is important to create appropriate internal structures for monitoring the transition and the implementation of the strategy, and for communicating progress to key stakeholders, including the board, investment committee and relevant staff members. This will ensure that the change management process involved in transitioning is effectively handled (see our summary implementation plan below).

> "It is critical to have clearly identified who is leading the process and what each party's responsibilities are."

Potential challenges on the impact investing journey

Our research highlighted several common challenges to impact investment experienced by foundations. These vary across organisations, particularly in relation to where these foundations are in their respective impact investment journeys. These include:

- **Limited opportunities for impact investment.** Having embarked on a strategy, many foundations found it difficult to find suitable investment opportunities, ranging from social enterprises to impact funds. Challenges include the riskiness of investments, particularly those that are just starting out and lack both a financial and impact track record making it difficult to assess the chances that the investment will succeed both in meeting financial and return objectives. Some have been frustrated by the limited financial literacy available within social enterprises – particularly entrepreneurs. Further, some foundations said that some investments required a minimum size that was bigger than the investment they were willing to make. This suggests that more needs to be done at a programme level to build better pipelines for more commercially oriented impact investing.
- **Lack of standardised resources and templates.** The absence of standard practices, frameworks, and templates can make impact investing complex and time-consuming. Impact measurement was identified as a significant challenge even by foundations with comparatively substantial experience as impact investors (we discuss this more in Chapter 4).
- **Internal capacity and skills.** Many of the foundations interviewed reported that they had limited internal expertise in impact investment, and so had to rely on external resources (including research off the internet that was less applicable to the local context. Advice from those charging fees was often prohibitively expensive). In most cases, the responsibility for developing and implementing an impact investment strategy sits with a single individual within the foundation.
- **Attaining board approval.** Some have found it difficult to align impact investment with long-held perceptions of a foundation's objectives and to integrate impact investment into the foundation's strategy, balancing low appetites for risk with the desire to maximise impact (see our implementation plan below).
- **Accounting complexities.** There are no clear accounting standards for some kinds of innovative funding instruments (we delve into this in Chapter 5) which can be a challenge for a foundation's finance teams and auditors.
- **Regulatory constraints**, particularly tax implications. Non-profit organisations' tax status often depends on their activities being seen as public benefit activities in terms of tax regulations. Impact investing can appear to be at odds with this, though there are ways to ensure consistency with applicable regulation, as we discuss in Chapter 5.

For foundations new to the concept of impact investment, a key challenge (understandably) is the lack of understanding of impact investing and how foundations can undertake it. Related to this are the challenges of pervasive misperceptions regarding impact investment, including conflation of the concept with corporate social investment, black economic empowerment or commercial investment.

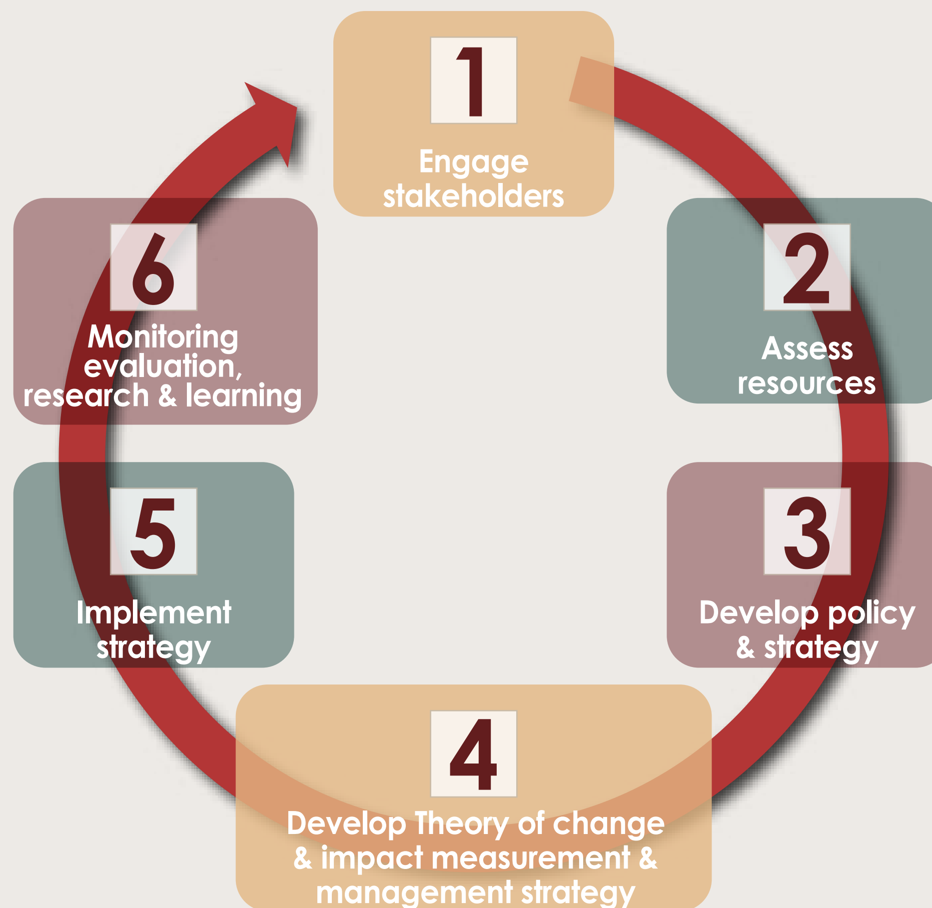
DID YOU KNOW

Several courses are available to teach the basics of impact investing. The University of Cape Town's Graduate School of Business offers an Africa-focused course on impact investing.

> "Non-profit organisations' tax status often depends on their activities being seen as public benefit activities in terms of tax regulations."

Getting started: An implementation plan

In this chapter, we have provided an overview of the principles and process for developing a strategy for impact investing as part of a charitable foundation's activities. As with any transition, the biggest challenge is often to get things started. Below is a possible route to follow, with a high-level overview of each step that we explore in more detail in the chapters noted.



STEP 1: Engage key stakeholders

Impact investing can be an intimidating topic for stakeholders in a foundation. Traditionally, the grant-making activities of a foundation are separate from the management of an endowment. Endowments are usually managed by an asset management firm with the single objective of generating appropriate risk-adjusted returns. That return on investment provides the funds used for grants and protects the real value of the endowment by compensating for inflation. Portfolio management requires different skills to the grant-making activities of a foundation, which are more often concerned with achieving social and environmental objectives.

The idea of bringing investing into the core activities of the foundation therefore implies changing fundamental principles of how a foundation is managed. It can also appear as if a totally different skill set is required. Naturally, stakeholders may feel a level of trepidation at the prospect. So, an important first step is to engage with those stakeholders to ensure that fears are managed and that any changes are achieved through a team effort.

The first step is to initiate a discussion with key stakeholders around exploring or introducing an impact investment strategy. As the lead governance entity, the board of trustees or similar structure is the primary starting point. With its buy-in, engagement can follow with the internal programme teams whose buy-in and support will be required.

Depending on the specific stakeholder's familiarity with impact investing, the point of the engagements may be some combination of the following:

- Introducing the concept of impact investing (see Chapter 1).
- Outlining at a high level what the shift would mean in practical terms (the questions set out in the rest of this chapter).
- Securing formal approval for a transition (partial or full) to impact investment and the development of related policies and strategies (Chapters 2, 3 and 4). This phase may also include engagements with local regulatory bodies (Chapter 5).

Keep in mind that the process of garnering buy-in is iterative and is likely to take some time.

STEP 2: Assess resource availability

It is important to assess the resources that will be required to introduce an impact investing competency, including financial and people (time and expertise). A transition strategy will be needed that suits the foundation's available resources or bring in external expertise.

Note that this strategy will need to be reviewed and approved by key stakeholders, which means there may be a repeat of steps 1 and 2 until consensus is achieved.

STEP 3: Draft an impact investment policy and strategy

This can be integrated with step 2, though is a separate process that develops the critical foundation for the impact investment strategy. The investment policy and strategy should reflect the foundation's impact investment vision that we've discussed in this chapter. The policy will outline the foundation's approach to impact investment and guide the investment strategy, which in turn will act as the base of the mandate for investment managers and other service providers.

Note that the details of the policy and strategy may affect resource requirements, which means there may be a repeat of steps 2 and 3 until resource allocation is finalised.

STEP 4: Draft a theory of change and set up measurement protocols

Using the investment policy as a guide, and keeping in mind resource constraints, draft the theory of change and identify appropriate impact metrics and measurement approaches *(Chapter 4)*.

STEP 5: Invest

Finally, the time comes to implement the investment strategy, either directly as part of programmes or through a third-party manager. Ensure that the impact investment policy and strategy remain the bedrock of any agreements made with external service providers *(Chapter 3)*.

STEP 6: Monitoring, evaluation, research and learning

Implement the measurement protocols, assessing an initial baseline for impact metrics and then carrying out regular measurement exercises throughout the life of the investment. Ensure that the findings of the measurement exercises are integrated into the investment strategy regularly, so that the strategy remains relevant and reflects the ultimate objectives of the foundation *(Chapter 4)*.

Communicate throughout

Be sure to communicate your journey to key stakeholders along the way, sharing the experience – including challenges and success – and lessons learned. This will not only ensure strong relationships with stakeholders through transparency but will also support market building as the key lessons learned disseminate throughout a growing community of practice.

investment structures

How to make an impact investment

How do you actually make an impact investment? As with conventional investments, impact investments can be made through many investment instruments. Which of these you use will depend on the kinds of risk and return, as well as impact features, you seek. In this chapter we discuss the issues to consider in thinking about the kind of instrument you use for your impact investment and illustrate how you can make a first impact investment. We focus here on the financial instruments that you would use rather than the impact features of the investment, which we cover in the next chapter.

Many foundations have not had investment as a core part of their activities. Usually, when a foundation has financial assets in the form of an endowment, an asset manager or other financial advisor manages the investments on an outsourced basis. As a result, making investments may seem an unusual activity. But, if you have followed the steps of the previous chapter, you will have the guidelines you need to take the first steps.

We outlined the basics of investment in *Chapter 1*. We discussed there how foundations can use grants to fund social enterprises and absorb some of the risks they face. Often that can enable them to graduate on to commercial investment sources as they build their businesses. Such grant-making can be seen as a form of impact investment itself, though common global definitions of impact investing (see the definitions provided in *Chapter 1*) would exclude it because there is no financial return at all. In this chapter we focus on instruments that are commonly accepted as forms of impact investing. We outline the key features of each instrument that you would need to understand in considering them as an investment tool. Our descriptions are focused on what you need to know about their investment features, rather than impact features.

Equity investments

As discussed in Chapter 1, equity is a higher risk investment than the other asset classes (bonds, cash, property) because you get a return only if the company you invest in makes a profit. But for the company, equity is a low-risk source of funding because it is patient, long-term capital. The company pays shareholders only if it generates profits and can afford to make payments. This makes it a better form of funding for start-ups and higher risk companies than borrowing. It is therefore often used in impact investing, such as when a social entrepreneur is aiming to develop a highly impactful new product or service. Equity investors obtain shares in a company in return for their investment.

KEY FEATURES OF EQUITY INVESTMENTS:

- You earn a return (called dividends) if the company makes a profit and the directors declare a dividend.
- Your investment results in an allocation of shares in the company, which is an ownership interest in the company.
- You can exercise control over the company by voting on resolutions made by the company, in line with the number of shares you own.
- Depending on the company's constitutional documents, if your ownership is material, you may be entitled to a board seat, giving you the ability to influence the strategy of the company directly.

Stages of investing

When a new company is set up, shareholders contribute funding to the company and get shares in proportion to the amount of funding they provide. For example, if a company requires R10m of equity funding and you provide R2.5m, you can expect to obtain an ownership interest of 25%. The number of shares the company issues can vary, but you would end up with a quarter of those in issue. For example, if the company issues 1,000 shares, your 25% interest would amount to 250 shares.

You can also take shares in a company through a follow-on investment. This is when the company issues new shares to raise more equity funding. This kind of investing follows **angel investing** or **seed investing**, a style of investing focused on helping a company get to the point where it has a viable product that can be commercialised. Several rounds of follow-on investment can happen as the company grows and these are sometimes called Series A, B and C rounds in the language of **venture capital investing.**

Investment stage	Seed or angel investing stage	Venture capital or growth stage
Description of company activities	The new social venture is developing products or services and doesn't yet earn any revenue. Angel investors support them, hoping they will succeed in creating a viable product.	A company has a product or service it can sell and now wants to scale up to reach as many customers as possible. This requires creating the capacity in the business to grow.
How much equity is raised	The company raises equity from investors, issuing 1,000 shares to raise R10m, implying the shares cost R10,000 each.	The company raises a further R10m, but this time by issuing 500 shares. This implies the shares are now worth R20,000 each, and a total of 1,500 shares are now in issue.
Example of a single investment	One investor puts in R2.5m, acquiring 250 shares, giving her a 25% interest.	The investor does not acquire any further shares in the next round. Her interest is diluted, as her 250 shares now amount to a 16.7% interest.
The value of the investor's interest	At the start, the company only held cash of R10m. The value of the shares could be seen as a claim on this money, so the 25% interest was worth R2.5m.	The original investment has appreciated in value, reflecting that it now has a viable product. The new round of investing valued the company at R30m, given that each share was valued at R20,000. This means that despite being diluted, our original investor's interest has doubled in value to R5m.

Let's say the company which raised R10m at the start-up stage now wants to raise more money to expand its operations. To raise another R10m it can issue 500 new shares to investors who subscribe and pay for them. After this expansion stage, the company will have 1,500 shares in issue. The initial 250 shares will now amount to a 16.7% interest in the company (250/1,500 shares). When new shares are issued, existing shareholders are diluted, which means their interest in the company shrinks in percentage terms (eg, from 25% to 16.7% in our example). However, existing shareholders always have the right to subscribe to new shares that are issued in proportion to their existing interest, so they are diluted only if they do not follow their rights. Also, when shares are issued, the company receives cash for those shares.

Depending on the subscription price of the shares, the initial shareholders may see the value of the company grow so that while their stake is diluted, it is over a larger value. Imagine, for example, that the company issued the 500 follow-on shares at a subscription price of R20,000 each, raising a total of R10m. This would mean the company was being valued at R30m. The initial 250 shares would now be worth R5m, having initially invested R2.5m. This scenario is summarised in the table below.

Valuing a company for equity investment

Critical in any equity investment is the value of the company in which you are investing. In the case of a start-up company, investors put money into it and the value of the company at the start is simply that amount. So, a company with equity of R10m is worth exactly that when it starts. However, as a company trades, its value will change, reflecting the value of its assets as well as its prospects. The original investors could see the value of their investment go up or down, as the company pursues its objectives.

When it comes to selling your shares in the company, or the company decides to issue new shares, it is very important to determine what the company is worth. Usually, shareholders will obtain professional advice to determine the value, from an expert advisor such as an accounting firm (common for smaller companies) or an investment bank (more common for large companies). There are a few approaches that can be used in valuing a company, and the best one will depend on the context and

Illustrative example: EQUITY INVESTMENT

Imagine a company that is developing a vaccine for HIV that is looking very promising, but it needs to undertake expensive clinical trials before it can sell the vaccine. This company is not suitable for a loan because it is not making regular income and couldn't pay it back. In this case, it may approach equity investors. Investors will value the business based on what income they expect it to make in the future and to assess the probability that it will succeed with the trials. Investors will then offer the company a certain amount of money in return for part ownership of the company.

The investor will make money when the company eventually generates a profit and pays dividends, or when they sell their ownership interest in the company. What the investor hopes is that as the company grows, its value grows so that when the investor sells, she will make a profit. For example, when it comes time to sell, it may have bought 15% of the company when it was worth R5m, but now it is worth R50m, so their interest would have grown by 10-fold.

The key issue for the equity investor is risk. The earlier in a company's development, the harder it is to predict that the company will succeed because of the limited track record. This means that the investor has a high risk of losing her money. However, the converse can be said in that, should an investor invest early and the company does well, she will make a significant financial return. Generally, the earlier someone invests, the more of a share she will acquire at a lower price. There is a natural tension because the more equity the company sells, the less of the business the founders of the company will own and therefore the lower the potential return for their efforts.

circumstances (see box alongside). Often, there will be a negotiation over the value of the company between buyer and seller and therefore you may want to have your own expert advisor.

Investors that prioritise impact may be willing to value the shares of impactful companies higher than investors not concerned with impact. So, it is important in your approach to equity investment to have a clear view on how much impact is worth to you. The next chapter gives you the tools to measure and manage impact performance.

Challenges and support

Apart from advisors on the valuation of equity investments, it is usually also important to have legal advice from a lawyer who specialises in private equity transactions. They can help draft and review contracts, including share subscription and sale contracts. It can also be advisable to draw up a shareholders' agreement to govern issues such as the first right to buy the shares of any other shareholder who exits.

In our interviews with foundations that are already undertaking equity investments, many cited that it was not so much the investment itself that was difficult, but the management of it thereafter, especially if the company got into distress. Being an active custodian of an equity investment can

> "Investors that prioritise impact may be willing to value the shares of impactful companies higher than investors not concerned with impact."

be demanding, assisting a company to achieve not just impact objectives, but also its financial success. Before undertaking equity investments, a foundation should think through the potential scenarios of how an investment might perform, and ensure it has the resources available to support it.

It is important to note that building a portfolio of equity investments needs to be done through the appropriate vehicle and you should consider how it might affect your tax status. More about this in *Chapter 5*.

HOW SHARES ARE VALUED

Usually when making an investment or selling shares, you will get an expert advisor to help value a company. They would typically use one or more of these approaches:

- **Present value models.** These determine the value by looking at what future earnings the company will generate and calculating what investors should now pay for those future cashflows. This approach is optimal when future earnings are easy to predict. The general idea is that money in the future is worth less than it is now (due to inflation), so to determine the value of a company you add up all the future cashflows and then discount them for the length of time until you receive them. The discount rate will depend on interest rates and the risks affecting the future cash flows.
- **Multiplier models.** These are often used for smaller companies and determine the price of shares by multiplying some fundamental variable, such as the earnings of the company. For example, a company making R2m/year can be determined to be worth R10m, using a multiplier of five. Earnings, net asset value and revenue can all be used, while the multiplier is based on common benchmarks, often by reference to multiples in listed markets for comparable companies.
- **Asset valuation models.** These determine value from the assets of the company less its liabilities. For example, if a company has cash and fixed assets worth R15m, and owes suppliers R5m, it would have a book value of R10m. Asset approaches are optimal when the company could cease trading.

Debt investments

Impact investors may also lend money to companies to achieve both financial return and impact. Loans can be a simpler entry to impact investment and a closer complement to existing grant-making programmes. As discussed in the previous chapter, loans can also be budgeted for out of grant-making budgets and become a form of recoverable grant if they are paid back.

A loan document

At its simplest, a loan needs only a written loan agreement. The agreement specifies the principal amount and the interest that should be paid on that principal. It can also specify any security (also called collateral) that the borrower provides in return for the loan – this is usually an asset that the lender can claim in the event of a default by the borrower, but many loans are unsecured and do not have collateral.

The loan agreement can also specify any **covenants** which are actions that the borrower must take, such as maintaining insurance, or not taking any additional debt without approval. It can also set out what would amount to a default, such as missing a repayment for a certain period or failing to observe the covenants. Typically, the agreement will also have a dispute resolution clause and other elements, such as rules over whether the lender can sell the loan to another party. A loan agreement is best drawn up with the advice of a lawyer, though once an agreement is drawn up it can be standardised and used for multiple loans.

Loans can be concessional, meaning that they are made on terms more generous than typically available to the borrower. Concessions can be in the form of lower interest rates or flexible terms for repayment.

Several foundations have developed small-scale lending programmes through which they channel loans to beneficiaries of their programmes,

Example: SMALL SCALE LOANS

The Financing for Impact Programme was launched in 2023 to address an issue that was identified in the SAB Foundation's annual surveys that access to further funding was a challenge to the entrepreneurs in its ecosystem.

The fund allowed selected alumni of its entrepreneurship and social innovation programmes to access affordable loans provided that they meet certain criteria. The aim of this growth fund is to further increase participants' turnover and create as many new jobs as possible.

Funding terms are determined case-by-case according to the cash flow cycles of the business and are for a term of five years to further assist with affordability.

Most commercial banks do not offer bridging finance or capital investment to small and medium-sized enterprises (SMEs) as it is considered too risky. Interest charged to SMEs by finance houses can be as high as 36%. This offering has been put in place to assist SMEs to fulfil a new contract or invest in capital for a growing business.

like entrepreneurs or women-owned businesses. These programme-related investments must consider the local laws and regulations for lending, which can have significant implications for how they are structured.

Loans must also be appropriate for the business that is borrowing. In determining whether a loan is appropriate, it is important to assess the cash flows of the business and how it will be able to pay the loan back. Even an interest-free loan requires that the borrower have enough cash at some point to be able to repay the loan. A loan can be made with flexible terms, for example, only requiring repayment when the borrower has the cash available. Such flexibility makes the loan more of a hybrid instrument (discussed below).

Setting up a small-scale loan programme, or even a programme that makes larger loans to social entrepreneurs, can be relatively straightforward, though it is important to plan carefully, and think through what you will do in various scenarios such as a default by the borrower. It is important to plan up front for the actions you will take in such scenarios and ensure you have the appropriate resources available. In order to protect your loans, you may need to implement a support structure for the business such as training and the assigning of a mentor.

Other forms of debt investment

Debt can also form part of the endowment and mission-related investment strategy. If a lending portfolio matures at the programme level, it can make sense for the endowment to fund that programme and then it will form part of the mission-related portfolio. An impact strategy, set out in the investment policy statement, can provide an allocation for a portfolio of loans that can complement programme activities. Typically, however, such a loan portfolio would need to be relatively low risk with predictable cash flows and repayment rates.

Debt impact investments can also be accessed through listed markets. On South African markets, these include:

- **Green bonds** which is debt raised by companies or public sector institutions, in which the use of proceeds is restricted to spending on green-related themes. Bonds are simply loan instruments, in which the buyer of the bond gains the right to receive the interest on the bond (often called the “coupon”) as well as the principal repayment when the bond matures.
- **Social bonds** which are similar to green bonds except that the use of proceeds is restricted to social development-related themes.
- **Sustainability-linked notes** which are debt instruments that have a financial reward for the borrower (ie, a reduction in the interest rate) if the borrower achieves pre-defined sustainability targets, or a penalty (increase in interest rates) if it does not.

The JSE also provides scope for transition bonds that are designed to fund transition from fossil fuel-based activities to greener alternatives, although at the time of writing none had yet been listed.

These listed instruments are already being used by some pension funds and other institutions to add impact features to their portfolio strategies. Foundations could make such instruments part of the mandate they give to an asset manager, in line with their investment policy statement.

Hybrid investments

We've so far discussed equity and debt investments. But there are several kinds of instruments that can fit somewhere in between these that can help manage the risks faced by investors and social entrepreneurs. We outline them below.

- **Convertible grants.** These are instruments that start as a grant, but then can convert into either debt or equity under certain conditions. For example, a convertible grant can be provided as seed funding for a social entrepreneur to fund research and development (R&D) on an impactful new product or service. Should the R&D lead to a discovery that triggers a new impact business to be set up, the grant can be converted into equity or debt in the new business. These kinds of instruments have been used around the world and are also known as "recoverable grants".
- **Forgiveable loans.** These are the inverse of convertible grants – loans that can be converted into grants. A loan is provided to a business and if it fails to generate returns needed to service the loan, it can be converted into a grant, leaving the business without the financial liability of a loan.
- **Convertible debt.** These are loans that can convert into equity if the company is not performing well. This kind of instrument helps the owners by not diluting their interest if the company performs as expected, but simultaneously it protects the lenders by being converted. They are often used by venture capital investors, enabling them to take priority over ordinary shareholders for repayment while the company is being established and reaching initial growth stage. Once it is stable, the loan can convert into shares in the company, allowing the investor to benefit from the performance of the company thereafter.
- **Guarantees.** A guarantee is a commitment to reduce the risk of an investment. In the context of foundations, the funder will offer security to a lender to a social enterprise in the event of non-payment. These can be useful in impact investing because they can catalyse investment flows by reducing the risks for investors. A guarantee can be a promise to repay the investor's capital if the investment doesn't perform, or it can be a guarantee against certain specific risks facing the investee, for example of a minimum amount of revenue for the business to earn from selling its products. A guarantee can also be partial, for example agreeing to pay up to 50% of the losses back to the lenders. With this in place, social enterprises which were previously uninvestable due to the risk now become viable for commercial investors. Guarantees are often used to drive commercial investors to take on risks and are used by international foundations like the Gates Foundation as well as development agencies like USAID.
- **Preference shares.** These are a form of equity that behaves similar to debt. A preference share gives the holder the first right to receive dividends, ahead of ordinary shareholders. However, the amount of dividend they can receive is capped at a set amount, so in that sense they are like lenders receiving interest.

However, if the company is unable to make payment, it can skip the dividend in any one year. In this way, preference shares also reduce the risk faced by lenders by adding an additional layer of funding that only needs to be paid a return if the company can afford it. Preference shares are often used by venture capital firms to ensure they are paid before ordinary shareholders, but without the financial pressure on the company that would come from debt. There are several varieties of preference share, including ones that can convert to equity in some circumstances, cumulative preference shares that allow for any missed dividend to be rolled into future periods and non-cumulative that do not, and redeemable preference shares that allow the company to repay the investor and cancel the shares at its discretion

- **Mezzanine debt.** These are loans that rank behind other loans, so are only paid once the senior loans are paid. Mezzanine debt usually has a higher interest rate to reflect the increased risk of non-payment that it pays compared to senior loans, but it can help catalyse other investors by reducing the risks they would face if a company had too much senior debt. Mezzanine debt is often used by impact investors to help a project attract other lenders through this risk reduction, catalysing them to also invest. Some mezzanine debt has equity participation rights, so the holder can either convert or have a right to participate in dividends. It is very similar to subordinated debt, indicating they are subordinated to other lenders.
- **Subordinated debt.** Catalytic capital can also be provided in the form of debt instruments that are called subordinated debt because they are ranked behind the senior debt providers and so derisk senior lenders, which are often typical commercial lenders.
- **First-loss capital.** This is a term that can encompass grants, convertible grants, equity and some kinds of subordinated loans. Certain funders like foundations agree to put money into a company with the understanding that if things go wrong, they are willing to lose their money first. This derisks the investment for other more commercial lenders and shareholders and encourages them to make investments that they otherwise may not have been able to make. First-loss capital can be provided to cover the initial expenses or costs incurred specifically in developing highly impactful new activities. Such first-loss capital is often called **"catalytic"** because it helps attract other funders into the company by reducing the risks they face. For example, **grant funding** could be used in an education technology company to build the technology, assist the entrepreneur with business skills training and test the market. Once there is proof that it works and that people are prepared to pay for it, the risk is lowered and other more commercial investors can enter. When a grant is provided as first-loss capital, it can create multiples more in funding by crowding in more commercial investors who are able to invest because the risks are improved by the grant funding. We discuss this more under blended finance models below.

These hybrid instruments can be structured similar to equity share subscription agreements or loan agreements, but you require specialist advice in setting them up.

Pooled investments

Investing on your own may seem scary. Many investors find it is easier to coinvest alongside other investors. This shares risk and can also facilitate learning by having the opportunity to see how other investors manage their investments.

A foundation can join a pool of fellow investors who combine their money into an impact fund. Typically, in these cases, an external fund manager manages the pool of funding and takes the investment decisions, according to the investment mandate of the funders (funds offered by asset managers are discussed more below). The fund manager charges a fee for this service and is accountable to its clients. In this case, the onus is on the client to ensure that the mandate is clear, and that the manager is held to account for allocating capital to investees that meet the financial return and impact criteria as detailed in the investment policy. Many private equity and private debt funds operate on pooled principles, with investors acting through a common law partnership which then appoints a fund manager (the general partner) to manage the investments on their behalf.

Pooled investments, however, don't need to rely on an external manager or formal pooling arrangement. Instead, a group of like-minded investors can jointly make an investment using any of the investment instruments discussed above. This can be done by forming an agreement between them, such as a shareholder's agreement in the case of equity in an unlisted company, which then sets out how they will manage the investment together.

Foundations could work with other foundations or similar impact-oriented investors (for example, high net worth family offices) to make such joint investments. Again, this can be a good way to learn and reduce risk, for example by co-investing alongside an experienced impact investor and walking through the process of assessing the investment opportunity with them.

Impact Investment case study

Enterprise name:
Vuleka

Description: The social enterprise Vuleka enables informal micro, small and medium township traders to improve their cash flow with more reliable supply chains and inventory financing through a buy now, pay later solution. Traders place orders for the goods they sell either manually through on-the-ground agents and phone calls or digitally via a mobile app or WhatsApp. Vuleka bulk buys the products directly from manufacturers, provides warehousing and carries out last-mile distribution services. Vuleka also provides credit to informal businesses based on inventory, which enables these businesses to grow in the absence of commercial funding, which they would not be able to access. Vuleka prioritises youth employment creation throughout its operations. The Vuleka app supports 300 informal business owners that order regularly, with a live database of 6,000 informal businesses on its books. To date it has employed 30 previously unemployed youth from the townships that it services, and has disbursed roughly R200,000 in credit to businesses that would otherwise not have been able to finance their operations.

Impact investment details: In 2017, Vuleka was awarded a R150,000 grant through the SAB Foundation Social Innovation and Disability Empowerment Awards. In 2019, the company applied to SAB Foundation's Social Innovation Fund and Accelerator Programme and received an interest-free loan of R600,000 which was accompanied by a two-year repayment plan, which has been repaid in full. Vuleka has also received additional interest-free loans from other organisations, including for profit corporations, through their enterprise development programmes.

Use of impact finance: Vuleka dedicates the investment returns received through impact investment towards growing its team and available infrastructure to service its beneficiaries. This includes hiring additional staff and purchasing additional warehousing. The impact investment received to date has enabled the company to achieve the scale needed to begin to source commercial equity investors.

Additionality: While Vuleka may have been able to access commercial funding to direct towards its scale-up efforts, it would have qualified for only a small amount and the repayment terms would have restricted the company's ability to maximise its impact. In an interview, the Vuleka team spoke of the additional value that is derived through the relationship with an impact investor, as compared with that available with commercial funders. The ability to discuss the purpose and vision of the company, and to have this factor in to the financing arrangements, rather than the details being solely based on financial performance, is crucial for social enterprises.

This is an example of the critical role that foundations can play in providing support beyond direct finance. By providing a combination of financial and technical support, impact investors have delivered exponential impact returns. In their effort to support a single enterprise, their investment has indirectly ended up supporting hundreds of businesses that rely on Vuleka's services for their day-to-day operations.

Notes for would-be impact investors:

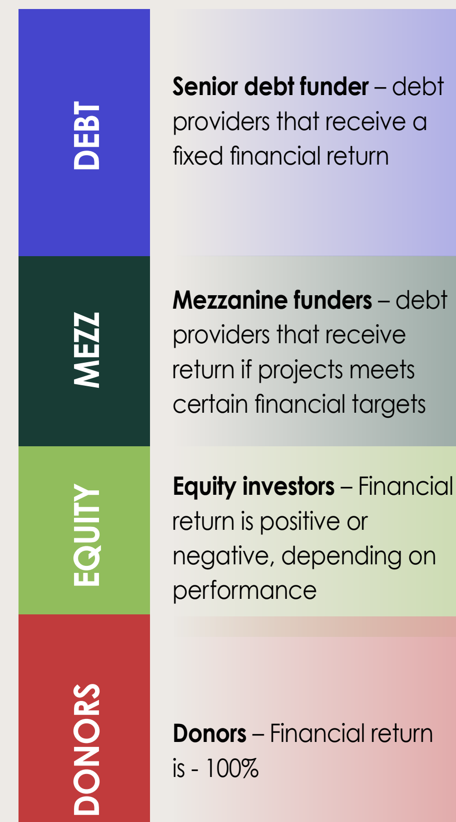
Vuleka benefited substantially from the technical assistance that has accompanied impact investment to date and notes that this is a critical and invaluable addition to financing arrangements. Supporting social enterprises in developing stable, resilient business cases that can attract commercial funding over time is a critical.

Blended finance models

The key idea behind blended finance is to use philanthropic grants and investments to crowd in commercial finance to back an impact project. It is not an instrument itself, but an approach to combining different instruments into how a company is funded, with the aim to maximise the total amount of funding. A blended finance model aims to achieve social outcomes more substantial than if the philanthropic finance was spent directly, by magnifying the amount of funding that backs the investment. We have talked several times in this and previous chapters about the notion of "derisking" an investment, for example by investing mezzanine funding, or providing grants to support the early-stage development of the company.

The idea of blended finance has a long history in corporate finance. The capital structure (the mix of different sources of funding) of any company has a "waterfall" which represents the risk that each investor faces. A senior debt provider has the lowest risk and is the first to be paid in the event of the liquidation of an entity. An equity investor faces much higher risk, as they will not be paid if the entity does not generate any profits. By introducing philanthropic capital into this waterfall, both equity and debt investors can be de-risked, because a new layer of funding is now available to absorb any losses before the equity or debt funders must incur losses. As a result, many investments that a commercial investor would not be able to consider can become viable. Commercial investors like banks, for example, are looking after the public's savings and must take a very low risk approach to what they lend money to.

This is why the role of philanthropic money in such ventures is commonly described as "derisking" the project. Such finance contributions can be made as grants, or as equity to help share the risk with other commercial investors.



Blending philanthropic money into the waterfall

Commercial funders will provide debt or equity (or a subordinated debt often called mezzanine finance that ranks behind senior debt providers). This is in the form of a "waterfall" which specifies who gets paid first in the event of liquidation. Senior debt holders take the lowest risk as they get paid first. Donors can introduce a new layer in the capital structure that "derisks" the others, making it feasible for commercial funders to contribute funding. For projects with high social returns, such catalytic funding can achieve better social outcomes than direct grant funding would.

This version of the waterfall is shown on the left.

Example: CATALYTIC CAPITAL IN ACTION

The **Oppenheimer Generations Foundation,** through its uMaStandi project, provided a combination of R15m in grant funding and R7.5m in technical assistance funding to seed a debt fund, which in turn catalysed R125m in investments for affordable housing. The funders of the facility included Nedbank, the Nedbank Black Business Partners Legacy Trust (which includes Old Mutual's participation), the SA SME Fund, Novo Impact Fund NPC and Apex-Hi Charitable Trust.

"We are proud that we were able to attract a mixture of funding partners, including a commercial bank and some innovative impact funders. It is especially important to acknowledge that we secured this support because of the catalytic funding provided by Oppenheimer Generations Foundation. These partnerships will be key to building on the momentum we have created during the past year as we move forward in 2023. For a developing country like South Africa, uMaStandi provides an innovative way for township developers to grow and deliver compelling value for property owners to diversify their portfolios while offering quality, affordable housing,"

– Lusanda Netshitenzhe, CEO of TUHF21.

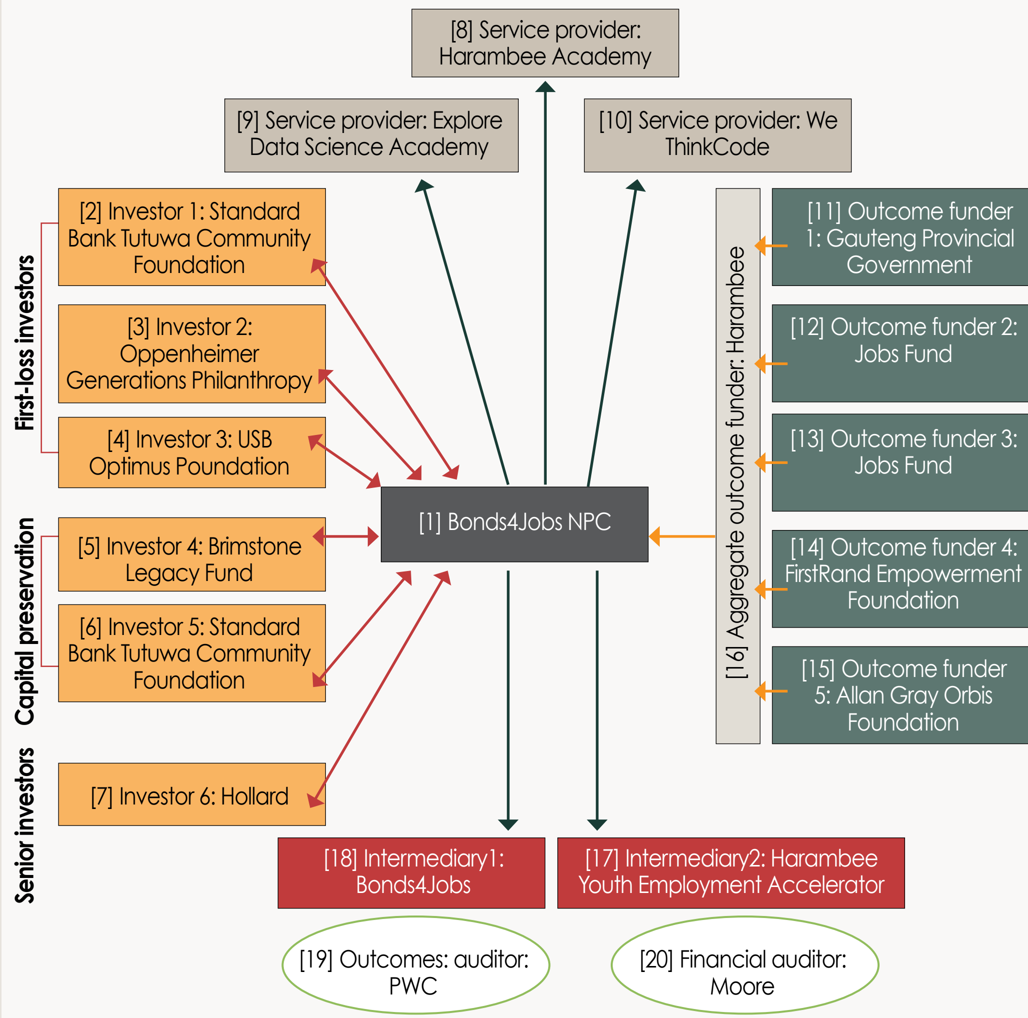
Blended finance uses catalytic capital from public or philanthropic sources to increase private sector investment to realise impact goals. Commonly, concessional capital and guarantees are used by the public or philanthropic sector to create an investment opportunity with acceptable risk for the private sector by improving the risk-return profile to bring it in line with the market for capital. In this way, blended finance allows organisations with different objectives to invest alongside each other while achieving their own objectives (whether financial return, social/environmental impact or a blend of both). The total value of the global blended finance market as at 2023 is approximately $15bn (Convergence, 2024).

Another example of a blended finance format is social impact bonds (SIBs). In essence, these are a contract with the public sector or philanthropic grant makers who pay for the delivery of social outcomes. The outcomes payments are then used to pay a return to investors, who fund the work done to deliver the outcomes. In the case of a SIB, repayment and return on investment are contingent upon the achievement of desired social outcomes. SIBs can carry a variety of outcomes instruments that also includes outcomes funds (see example box on the next page).

Example: BONDS4JOBS

The diagram below demonstrates how foundations can act as both investors (Tutuwa and Oppenheimer Trust) and outcomes funders (FirstRand Empowerment Foundation) that provide grants in return for obtaining certain specified outcomes in a social impact bond structure (Krutham, 2021).

Figure 6: Bonds4Jobs



Bonds4Jobs (B4J) was divided into two delivery cycles. In the first cycle, which ran from April 2018 to January 2019, three investors [2, 5, 7 in the diagram on the left] supplied working capital to the B4J SPV [1]. These funds were then transferred to the Harambee Academy [8] (the training division of Harambee Youth Employment Accelerator) to deliver employment services (profiling, job matching and training) to unemployed young people (aged 18-35) from disadvantaged backgrounds. B4J aimed to test whether eventual placement could be into well-paying, complex jobs that might meaningfully change the trajectories of the young people's lives.

When the Harambee Academy achieved its targets for job placements in January 2019, two public and two private outcome funders [11, 12, 13, 14] repaid the investors, which were arranged in a blended capital stack. This meant the senior investor [7] was paid out first, with the highest interest rate, followed by investor [5], whose capital was guaranteed with zero interest, and finally investor [2]. Had Harambee Academy underperformed in the first performance cycle, investor [2] would have been the first to absorb these losses. Underperformance would have to fall below approximately 30% of the target before the senior investors would begin to suffer losses.

In the second performance cycle, planned to run from January 2019 until June 2022 but terminated in June 2020 due to Covid-19, additional first-loss [3, 4] and senior [6] investors were brought on board, as well as an additional (private, philanthropic) outcome funder [15]. To achieve larger numbers of job placements, two additional service providers [9, 10] also joined B4J, replicating the Harambee Academy's service delivery model. Harambee Youth Employment

Accelerator [13] acted as the technical intermediary [17] and provided capacity building and monitoring services to the additional service providers, set performance targets using its market research, and managed reporting to the various participants. The financial intermediary, Bonds4Jobs [18], solicited and managed investments. The auditors [19, 20] assured the service delivery and financial performance respectively.

B4J offered competitive financial returns, especially to senior investors, with slight under-performance against the outcome targets having no impact on investors' returns. Due to the early termination of the SIB, B4J decided to use its reserves to pay out investors in full: their principal plus full interest up to the end of year two.

A note on public and private markets

We conclude this chapter with a primer on how investments divide into public and private markets, which is important background knowledge to support your investment insight. In **public markets**, investors purchase shares listed on an exchange, such as the JSE. The big banks, supermarket chains like Pick n Pay or Shoprite, mining companies like Anglo American, all list their shares on exchanges where investors can trade them through stockbrokers. They assemble portfolios of these shares and can easily buy or sell them. Debt can also be traded on exchanges, though this is usually traded by big institutions.

Government bonds make up most of the debt instruments that are traded but there is a growing number of debt instruments that have impact features, such as green and social bonds, and sustainability-linked bonds that we discussed above. We often call these "listed" investments because they are listed for sale on an exchange.

Private markets, in contrast, are where most companies raise investment – by selling shares directly to shareholders or raising debt from investors. Most social entrepreneurs seek investors of this sort, particularly when they are starting out or growing their businesses. Impact investors tend to be focused on these kinds of companies.

In the case of listed companies, investors' influence over the company is limited to the rights that shareholders have to vote on resolutions. Usually, an investor is one of many so has a small say in the decisions regarding the company. Nevertheless, even in such cases, an investor can apply an impact strategy through their stewardship role, using their influence to guide companies to have a positive impact, for example by tabling shareholder resolutions calling for the company to disclose information about its impact on the environment.

If other shareholders are aligned, this can have a material effect on the behaviour of companies. Investors can incorporate provisions for active stewardship of this sort in their investment policy statements discussed in the previous chapter.

> "One indirect way to gain exposure to listed markets is by investing in specialist impact funds."

There can also be opportunities to back impact investment on public markets, though this is more the case in larger economies where social enterprises raise capital on exchanges by issuing bonds (a way of raising debt using a listed instrument) or by listing their shares.

While there are some listed debt instruments in South Africa such as green bonds and sustainability-linked notes which enable the achievement of certain impact objectives, the public markets are not a common way for social enterprises to raise investment. However, the public markets are an easy way to make investments, as it can be done through a stockbroker and there is usually extensive information available about such investments.

One indirect way to gain exposure to listed markets (as well as some unlisted investments) is by investing in specialist impact funds. These are managed by asset managers and have a specific mandate to invest according to impact principles. For example, Futuregrowth offers a suite of development funds that focus on developmental assets. Its Infrastructure & Development Bond Fund aims to deliver a return of 1.25% over the main bond index before costs, but also deliver a social impact mandate including job creation, affordable housing and access to services and healthcare.

Private markets are where most companies raise investment, especially smaller ones. Private market equity investments, often called **private equity**, tend to offer greater potential for impact through the comparatively greater degree of influence that ownership offers the investor, and because social entrepreneurs tend to be building businesses that are still small. Most social entrepreneurs start out raising funding from impact investors for private companies, both in the form of equity or debt.

For foundations, particularly for programme-related investing, making investments into such social enterprises through private markets is the main mechanism for an impact strategy.

Investments can be through loans or through shares issued by the company. For a foundation making its first impact investment, having set out a strategy, the next step is identify the kinds of investments you want to make, guided by the investment policy statement explained in the previous chapter.

Investors can back such companies through private equity and debt, often with larger percentage stakes in the companies. They also can also be important in the start-up or scale-up phase of a company's evolution. Investors may take seats on the company's board as part of the investment agreement.

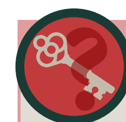
Private investment is often managed through a private equity fund manager (usually called a **general partner**) which manages a portfolio of investments on behalf of several investors, although there are several examples of impact investors making direct investments without the mediation of a general partner. One option for foundations, particularly at an MRI level, is to invest in a private equity fund with a specific impact mandate. This positions the foundation as a **limited partner** and operates in effect like a pooled investment, but the general partner acts as the fund manager, making the investment decisions and acting as a custodian over the investments. For example, Old Mutual Alternative Investments manages the Education Investment Impact Fund of South Africa, which aims to provide investors with competitive returns while also seeking to achieve a positive social impact through employment creation, transformation and environmental sustainability.

Example: BUILDING A PORTFOLIO OF EQUITY INVESTMENTS

The **Oppenheimer Generations** Philanthropies' Entrepreneurs for Entrepreneurs (E4E Africa) is a venture capital fund that supports early-stage businesses. E4E Africa's first fund was solely focused on South Africa, with its second fund expanding its geographic reach to include southern and eastern Africa. E4E Africa invests in Africa's best entrepreneurs who build scalable businesses that address the continent's major problems.

E4E Africa deploys entrepreneur-aligned growth capital by investing early in companies while it is also able to provide scale-up capital for outperformers. E4E Africa provides hands-on business-building support to founder teams through its team of experienced founders and investment professionals backing the next generation of African entrepreneurs.

Oppenheimer Generations Philanthropies, through its OG Impact Fund, invested in E4E Africa in September 2022. The purpose was to provide much-needed early stage investment capital to businesses that made a positive impact on communities. As part of its broader efforts to support the early stage venture ecosystem, the OG Impact Fund also provided a technical assistance grant that would enable E4E to provide additional resources and attention to businesses in its portfolio.



Key questions to consider from this chapter

Which investment instrument (or combination of instruments) best suits the foundation's objectives?

Impact measurement & management

As we discussed in Chapter 2, impact investing focuses on three different investment considerations: return, risk and impact. A traditional investor focuses on risk and return, while an impact investor adds the third consideration. In this chapter, we explore how an impact investor should approach the measurement and management of impact.

Impact measurement and management (IMM) is an essential component of effective impact investment. It enables an impact investor to understand the extent to which they are achieving their intended impact objectives. Many foundations already have capabilities to measure the effects of their activities, and impact measurement and management draws on many similar tools. However, while typical measurement approaches aim to assess the effects of a grant, in our context the aim is to assess the impact of an investment.

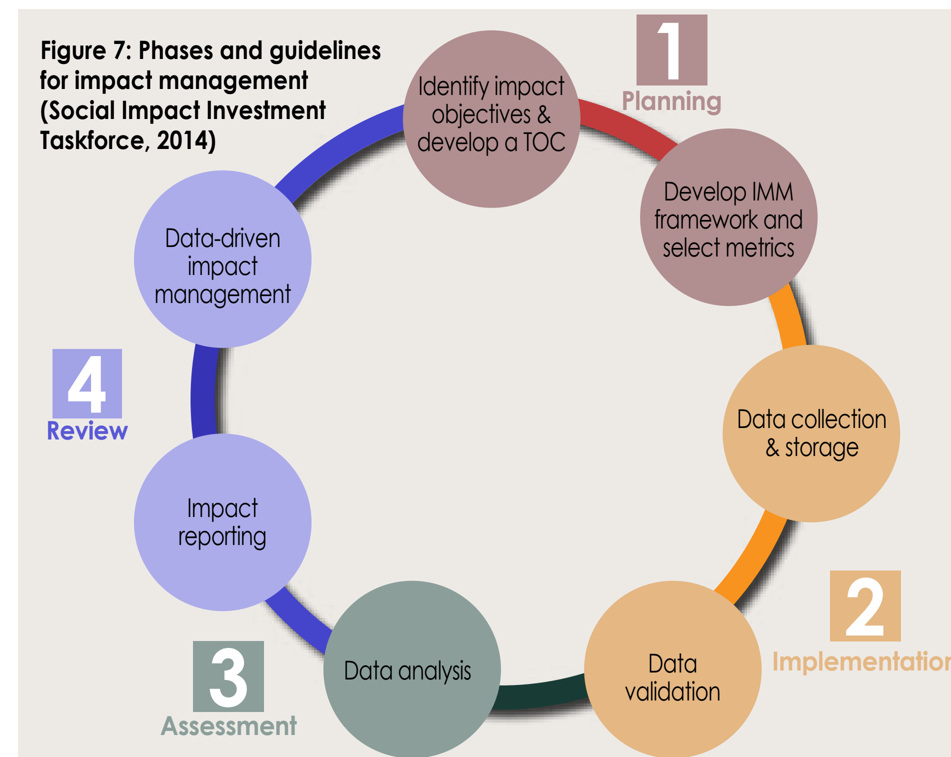


Figure 7: Phases and guidelines for impact management (Social Impact Investment Taskforce, 2014)

Impact measurement enables an investor to:

- **assess** the effectiveness of supported interventions;
- better **allocate** resources to more impactful projects;
- ensure **accountability** both of investees and the impact investor to stakeholders;
- **manage** processes to ensure continuous improvement and to maximise future impact; and
- more effectually **communicate** impact achievements.

If carried out correctly, the impact measurement and management process is iterative and allows for ongoing learning and improvement over time.

A robust IMM process typically has four phases which enable the investors to develop a strong framework for impact measurement. The diagram on the left illustrates the main phases and guidelines for impact measurement.

Developing a theory of change

To be effective, an impact investor must understand what exactly they intend to measure, how to measure it and the purpose of measuring. This is contained within the organisation's theory of change.

A theory of change is a clear, logical framework that outlines how an investment is expected to lead to the desired outcomes and impact. It sets out the critical assumptions underlying the intended impact and provides a framework for measuring progress towards specific objectives.

Developing a theory of change involves:

- Determining the long-term goal or vision. The ideal endpoint of the theory of change should be as clear and realistic as possible while retaining a level of ambition that stretches the organisation.
- Determining the intermediate outcomes necessary to achieve this goal. Achieving the ultimate objectives of the investment strategy is made possible by achieving intermediate targets, identified by establishing the links between outcomes and their sequence, and by understanding causes and effects.
- Mapping out the activities and inputs required to produce these outcomes, using a clear and logical framework.
- Assessing important enabling factors and barriers, such as key stakeholders to engage along the way.

A theory of change is most simply depicted through an "impact value chain", which outlines a logical progression of activities, outputs, outcomes, and the ultimate impact. Below is an example of an impact value chain for employment creation through investment in education, with a long-term objective of creating sustainable livelihoods.

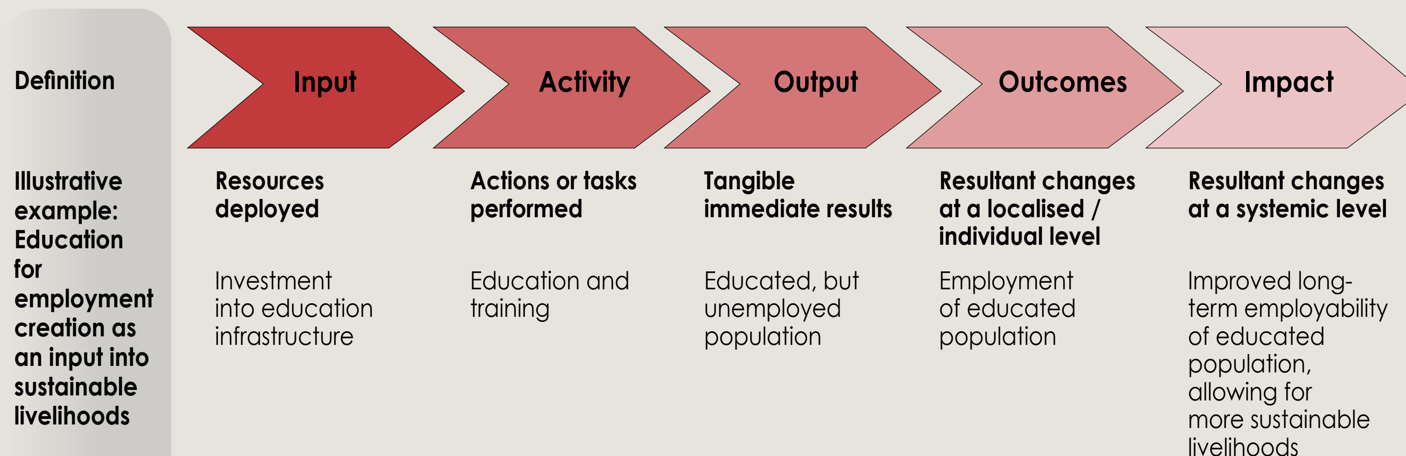


Figure 8: Phases and guidelines for impact management (Social Impact Investment Taskforce, 2014)

COMMON PITFALLS IN DEVELOPING A THEORY OF CHANGE

Developing a theory of change is straightforward but not always simple, and foundations should avoid some common pitfalls.

1. **Including elements that are neither activities nor outcomes.** Your theory of change should focus only on the changes that you expect to occur as a result of what you do.
2. **Overcomplication.** A theory of change should be simple and clear.
3. **Overclaiming.** Ambitious impact objectives are important, but so is pragmatism. Foundations should stick to outcomes that are proportionate to their levers of influence and resources.
4. **Flawed logic.** Above all else, the theory of change must make sense. Outcomes must logically lead on from another. To ensure this happens, it may be necessary to include more steps in the chain or describe the interactions differently.
5. **Overcrowding.** Changes should be captured one at a time, rather than linking too many outcomes to a single input or activity.
6. **Duplication.** While outcomes can be interdependent and causal links are not always linear, change should be plotted in a simple and straightforward manner, avoiding duplicative causal links and feedback loops.
7. **Ambiguity.** Specific descriptions are key to effective impact measurement and management.

(Adapted from Investment Impact Index, 2020).

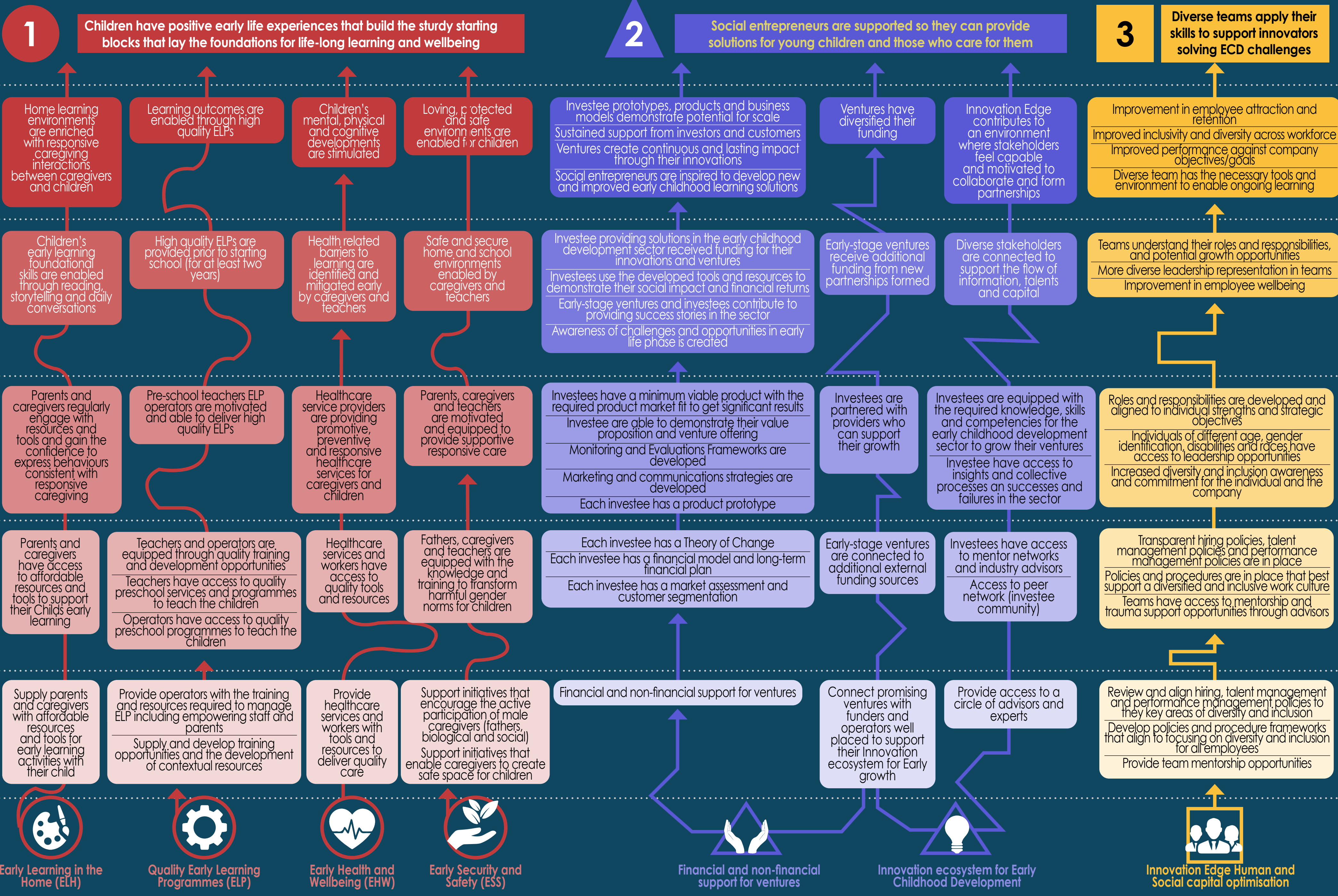
Example: THEORY OF CHANGE

Innovation Edge was founded in 2014 through a partnership between the Omidyar Network, the UBS Optimus Foundation, the DG Murray Trust, the FirstRand Foundation and the ELMA Foundation. The organisation's mission is to support entrepreneurs and social innovators to develop, test and launch innovative solutions to early childhood challenges. On the next page we present its theory of change, with a detailed view of the steps involved in reaching their goal.

INNOVATION EDGE

Theory of Change

Igniting the ecosystem around mission-aligned entrepreneurs and ventures that focus on solving early life and early learning challenges in South Africa



Identifying impact metrics

In deciding which metrics to measure, it is important to ask a few key questions.

- Is there credible evidence of a **causal link** between the metric in question and the outcome objective? If not, then collecting this data is unnecessary and potentially irrelevant.
- Does the metric measure an outcome that the investment-supported activities **directly influence** (rather than indirectly support)? It is important to focus measurement on the impact that is attributable to the activities of the impact investment intervention itself.
- Is it **plausible** to collect data for this metric (ie, are the necessary resources in place)? Certain kinds of data might be more difficult or costly to collect in a credible way, in which case alternatives should be sought.
- Will the collection of this data enable comprehensive **analysis** that can feed into the management of the investment strategy? The data must be credible and comparable over time to track impact effectively.

Better metrics are those that answer "yes" to the above questions. They will enable impact measurement and management which are fit for purpose and maximise efficiency and impact.

In addition to the questions outlined above, the investor must also consider the following when selecting metrics or indicators to monitor its impact:

- What are the investment level KPIs for each individual investment? Keep these simple and easy to measure (based on the questions outlined in the previous section). Make sure they can be linked to the foundation's mission and broader impact objectives.
- What is the baseline performance at the start of the investment?
- At what frequency will the performance measurement take place?
- How and by who will the indicators be measured, captured and reported? Does the investee have the human capital, tech, tools and resources to properly obtain and track data?

Important to note

Collecting impact performance data from investees is critically important to ascertain whether the intended impact has been achieved. Impact reporting requirements should therefore form part of the contractual obligation of investees.

Impact funds: labels and ratings

As with any traditional investment fund allocation, allocation to impact funds should be done according to a robust due diligence process. This can include using labels, taxonomies and sustainability ratings.

Several platforms and service providers are available to provide data on the impact features of investments to would-be impact investors. Data providers like Sustainalytics, MSCI, ISS and S&P Global provide ratings of listed instruments against ESG criteria. Funds and other issuers have ratings based on an assessment of variables such as social impact, avoidance of ethical controversy, quality of environmental and social governance, financial confidence and transparency.

It is easy to conflate impact ratings with sustainability ratings. It is important to note that sustainability ratings are not perfectly suited to impact funds as they are compiled using publicly available data, and as such tend to be biased towards funds investing in larger, listed companies that have better reporting capabilities, rather than true impact funds, which tend to invest in smaller companies.

Increasingly, regulations are also being introduced to govern the labels that funds use. For example, the European Union has made an effort to untangle the often confusing language around responsible investing and impact investing through its Sustainable Finance Disclosure Regulation (SFDR). The SFDR creates a taxonomy for different kinds of investment vehicles, with Article 8 and 9 funds having a form of impact. Article 8 funds are those that seek to promote sustainable outcomes, whereas Article 9 funds are those specifically designed to achieve particular impact targets.

To keep things simple, when assessing an impact fund, it's important to get a sense of track record, strategy and core composition (largest holdings). This will usually allow for an understanding of where the fund has come from, where it is going, and the principles it applies to how it allocates capital.

Impact Investment case study

Enterprise name:

Reel Gardening

Description: Reel Gardening is a South African social enterprise that manufactures a patented, biodegradable seed tape used to grow non-GMO vegetables and herbs easily, economically, and with significantly less water. Reel Gardening employs 62 people permanently and operates agri-hubs nationally to enable income generation for communities from household gardens. It has also developed a product for low-income households, the household garden in a box, which supports the annual food requirements of a family of four. In the last few years, Reel Gardening has distributed over 300,000 household gardens and 4,500 school gardens and manufactured 20 million 'little gardens' for the 2020 Checkers campaign.

Impact investment details: In 2011, Reel Gardening was the overall winner at the SAB Foundation Social Innovation and Disability Empowerment Awards, receiving R1m in funding. In 2017, the SAB Foundation, through its Social Innovation and Accelerator Fund, provided Reel Gardening with an interest-free loan of just under R1m. In 2018, additional unconditional grant funding was received from a commercial bank through its own awards programme. In addition, Reel Gardening is a recipient of project-specific funding from a range of institutions, including development finance institutions.

Use of impact finance: The team at Reel Gardening used the initial SAB Foundation grant to settle existing debt and to expand their operations. This money also went toward establishing the not-for-profit arm of the business, designed to support impact-first projects. The interest-free loan granted in 2017 went toward mechanisation of Reel Gardening's operations, which enabled the company to secure a large contract with a major retailer. The funding received in 2018 was used to invest in innovative technology that allowed for expansion of the business's operations and team. Since then, the business has been able to direct a combination of profits and grant funding toward its own investment portfolio, which has grown to the point where the business is now self-sufficient. This means that though they would qualify for it, there is no need for the business to access commercial finance.

Additionality: The Reel Gardening team reports that without the initial injection provided by the SAB Foundation in 2011, the company would have gone out of business that month. At that point, the business had exhausted all available avenues for funding and had accumulated significant debt in the process. Further, Reel Gardening's leadership notes that without the technical assistance and "supportive community" that accompanied the funding from SAB Foundation, it is likely that the business would have made similar mistakes and ended up in debt once more. The ability to direct this funding toward maintaining and expanding the operations of the business is distinct from project-specific funding, which does not necessarily empower a business to increase its longevity in the same way. By supporting a single social enterprise, that otherwise would have gone out of business, these impact funds have indirectly contributed to the food security of hundreds of thousands of South Africans.

Notes for would-be impact investors:

By providing a concessional loan, a foundation not only provides much-needed funding for a social enterprise to operate and potentially expand, but also provides an opportunity for that business' leadership to learn the principles of debt repayment, decreasing the potential for debt accumulation in the future when they eventually gain access to commercial funding.

Reel Gardening conducts extensive IMM and is able to attribute impacts directly to its interventions. These findings are reported directly to a selection of Reel Gardening's funders, who provide detailed templates for impact reporting. Foundations looking to invest for impact should consider implementing IMM and reporting requirements that can enable the foundation to attribute impact directly to its investment.

Selecting a measurement approach

Once the theory of change has determined what to measure, a decision must be made on how measurement will be done. Views may differ regarding which methodologies deliver the most credible evidence. The most appropriate methodology will be a function of the nature of the data itself (for example, whether it is qualitative or quantitative), the environment in which it is to be collected and the resources available to do so. It is important to get this in place at the outset, to ensure that measurement is built into the investment criteria and the contractual obligations of the funding recipients.

Commonly used approaches include:

- **Statistical approaches** that identify patterns in quantitative data (including "before" and "after" comparisons, correlation, regression analysis, and other statistical models).
- **Experimental approaches** that compare differences in outcomes between people who receive a service (the intervention group) and people who do not (the control group).
- **Case-based approaches** that draw conclusions on cause and effect through comparison of cases within an intervention or programme, or across investee companies, interventions or programmes.
- **Theory-based approaches** that rely on observations by key stakeholders, including beneficiaries, to ascertain the impact of an intervention.

Each approach will have its strengths and weaknesses, and it may be most appropriate to use multiple approaches in combination to collect evidence of impact. Ultimately, it is up to the impact investor to decide which of these approaches is best suited to their impact mission.

COMMON IMPACT MANAGEMENT METHODS AND TOOLS

Quantitative
Surveys/questionnaires
Psychometric scales
Case work tools/records
Statutory data

Qualitative
Interviews
Observation
Focus groups
Anecdotes and feedback

Approach	Strengths	Weaknesses
Statistical	Data collection and pattern identification are straightforward.	Requires significant sample size and quality data. Does not explain causation.
Experimental	Avoids bias.	Does not account for nuance (results cannot be generalised). Does not explain causation.
Case-based approaches	Identifies cause and effect relationships.	Inapplicable in complex environments.
Theory-based	Context-specific.	Susceptible to bias in interpretation.

Measuring impact

Impact data should be collected at key points in the investment process, including at the outset (baseline data) and in regular intervals as appropriate throughout the implementation of the impact intervention.

Impact data integrity will be a function of how data is captured and stored. It is critical that the information technology, tools, resources, human capital and methods used to obtain and track data from investees function properly and cohesively.

Data quality assurance can be obtained through validation processes such as cross-checking or through external verification by independent third parties.

Measuring indirect impact

Often, it is possible to measure impact beyond the direct result of a particular intervention or company's operations. This is usually done using econometric models that extrapolate direct impact data to measure indirect and induced impacts. Specialist tools exist for this purpose, dependent on the nature of the project being assessed.

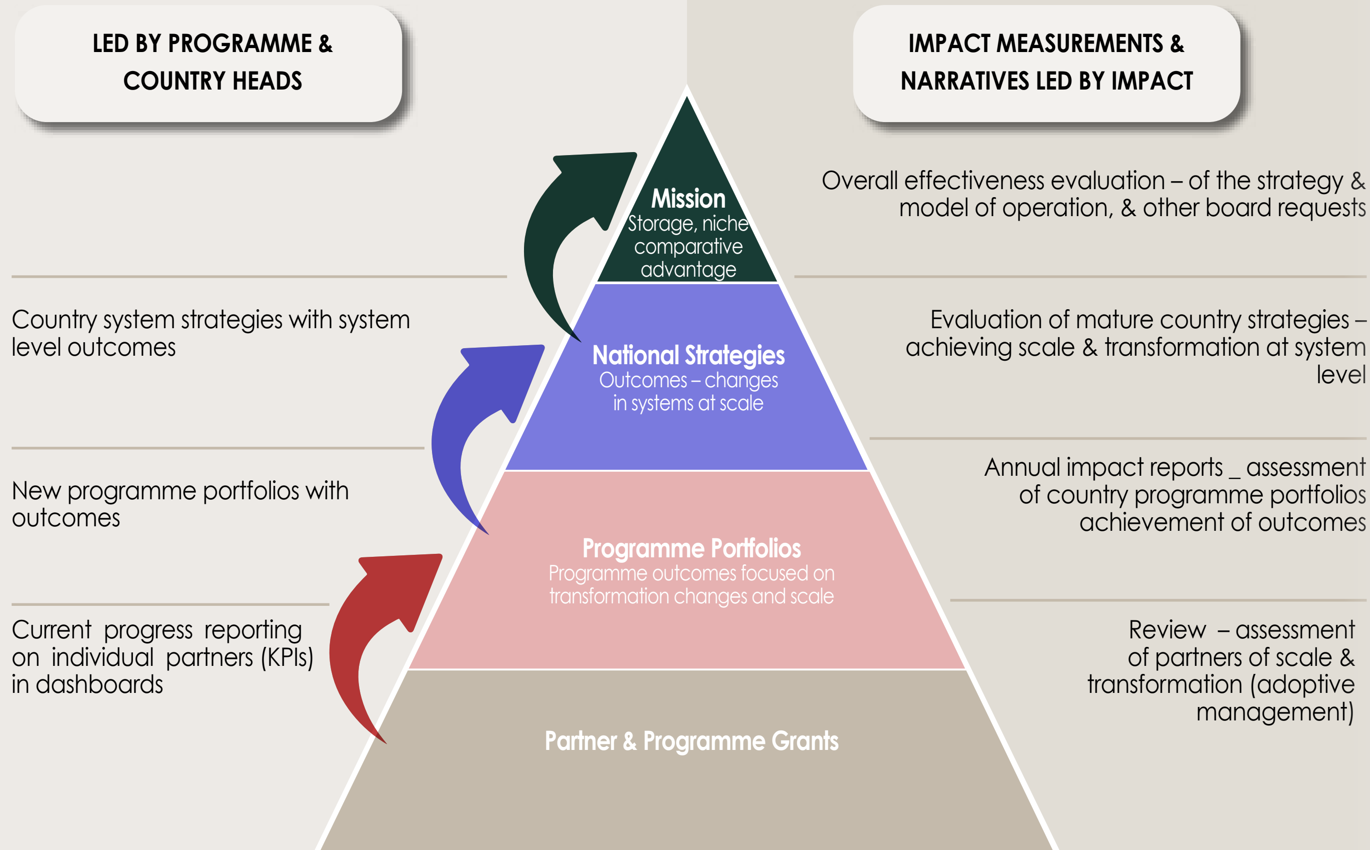
Monitoring, evaluation, research and learning

Once collected, it's important to analyse impact data to ascertain whether the impact being achieved is aligned with the investor's ultimate impact objectives. This enables tracking of progress against targets.

At this point, it is appropriate to communicate the impact achieved to key stakeholders, both to keep them informed of progress and to garner feedback.

The feedback received from key stakeholders can be combined with the findings of the data analysis to revise the theory of change or even to refine the impact investment strategy.

Figure 9: The Impact function at the Mastercard Foundation



Example: ADAPTIVE MANAGEMENT

The **Mastercard Foundation** has established a specific foundation-wide impact function, with the role of evaluating the extent to which programme portfolio investments are delivering impact objectives and the extent to which country-level strategies are being, or have been, transformed to sustain impact. A critical role of the impact function is to commission independent assessments of the foundation's operations and to give feedback on key learnings to foundation leadership to enable adaptive management of impact programmes.

Impact risk

In Chapter 2 we discussed the three vectors of risk/return/impact that should be considered in impact investment decisions. The risk analysis should consider the financial risks – such as the risk that the investee cannot repay the investment or otherwise fails – as well as the impact risk, which is the risk that the investee fails to deliver the intended impact. These two are interlinked in that the ability to achieve the impact may also be influenced by the inability to secure all the necessary finance.

As part of developing an IMM framework for your impact strategy, it is important to include a risk analysis and risk management component. As experts in the social impact space, you already have a strong advantage in that you understand what the big social/environmental problems are and what real impact looks like. The first question to answer for yourself is: Given your knowledge of the problem, do you believe that this is a real solution to that problem? There are various kinds of impact risks to think about which are listed in the table below left.

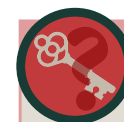
A typical approach to risk management is to analyse each of these risks and determine how they may affect the investment you are making. You can then assess the **likelihood** of each risk and the **severity** of that risk, should it materialise. Through such a process you can gain insight into the risks facing an investment which can be taken into consideration when deciding if an investment is appropriate. If the investment goes ahead, you can then use the information to prioritise dealing with the highest likelihood and severity risks. You can formulate a plan to decrease the likelihood of each risk occurring and work to decrease the severity of the risk should it occur by putting in place a mitigation plan. One approach is to put together your risk analysis in a table like that shown in table below right (where we've put in an example of an execution risk mitigation plan):

Impact Risk	Definition
1. **Evidence risk**	The probability that insufficient high-quality data exists to know what impact is occurring
2. **External risk**	The probability that external factors disrupt our ability to deliver the impact
3. **Stakeholder participation risk**	The probability that the expectations and/or experience of stakeholders are misunderstood or not taken into account
4. **Drop-off risk**	The probability that positive impact does not endure and/or that negative impact is no longer mitigated
5. **Efficiency risk**	The probability that the impact could have been achieved with fewer resources or at a lower cost
6. **Execution risk**	The probability that the activities are not delivered as planned and do not result in the desired outcomes
7. **Alignment risk**	The probability that impact is not locked into the business model
8. **Endurance risk**	The probability that the required activities are not delivered for a long enough period
9. **Unexpected impact risk**	The probability that significant unexpected positive and/or negative impact is experienced by people and the planet

Source: Impact Management Project

Risk	Likelihood	Severity	Mitigation plan
Execution risk	High	High	Given the investee is a start-up without a track record, it will require mentorship and close monitoring to reduce execution risk. We will therefore appoint a board member and provide a mentor to the CEO to ensure they are supported to keep execution on track.

The impact risk assessment can be combined with the financial risk assessment and form a key part of the investment decision process and then the post-investment management plan.



Key questions to consider from this chapter

What is the impact that the foundation intends to measure?

How does it intend to measure it?

How can the foundation mitigate identified impact risks?

Tax, accounting and legal compliance

Impact investment is a relatively new field and few regulatory systems have adapted fully to accommodate it. Traditional regulatory approaches draw a sharp distinction between public and private benefits. Incentives such as tax breaks are available for the non-profit sector because they provide public benefits. However, investing has traditionally been conceived of as providing private benefits and is therefore treated differently. The idea of investing that achieves both public and private benefits is novel and there has been limited adaptation of tax and other regulations so far. There is nothing prohibiting foundations from engaging in impact investment, whether through direct investments, listed investments or through funds, though there are some important considerations for how these are done that we discuss in this chapter.

A changing landscape

The G8 Taskforce on Impact Investing made a series of recommendations for governments around the world that, in its view, would promote impact investing. These include (Social Impact Investment Taskforce, 2014):

- Improve access of impact entrepreneurs to capital, including seed, early-stage and growth capital.
- Create legal forms or regulations that protect the social mission of impact-driven businesses.
- Relax regulations that prevent social sector organisations from generating revenues.

Many countries are still on the journey of implementing these recommendations, including those in Africa. Unfortunately, for foundations, this often means the regulatory considerations can change and there are several grey areas.

The most important factor in most jurisdictions is the tax status of the non-profit entity. Several jurisdictions,

Creating an enabling environment for impact investment

The FirstRand Empowerment Foundation has spent the last five years exploring the potential for increasing its involvement in impact investment. Along the way, it has come up against the challenges presented by tax regulations related to retaining its Public Benefit Organisation (PBO) status. In response, the foundation has decided to direct resources towards supporting research aimed at advancing the South African policy and regulatory environment so that it is conducive to catalysing and accelerating impact investment – not just for foundations, but in general.

including South Africa, give certain tax privileges to non-profit organisations. For example, non-profits in South Africa that are engaged in certain public benefit activities, defined in the Income Tax Act, can gain exemption from income tax. Donors to such public benefit organisations can also make donations out of pretax income, subject to limits (using Section 18A of the Income Tax Act). They are also able to gain beneficial treatment for VAT. These benefits can be at risk if impact investing risks the public benefit status of the foundation.

In this section, we consider the relevant tax issues but start with how a foundation should manage its financial accounts for impact investing.

Accounting for impact investing

Traditionally, a foundation has a clear distinction between revenue and expenditure related to its operations and investment activities. Revenue and expenses are accounted for through the income statement, while the endowment portfolio is held on the asset side of the balance sheet.

Impact investing somewhat scrambles the lines, in that certain kinds of investments do the job of a grant but have the potential of delivering returns. This can present challenges for how they are accounted for. Additionally, some impact instruments have complex features like returns tied to the impact performance of the investment, which introduces additional accounting challenges. The complexity will also be a function of the foundation's accounting policies, whether it applies International Financial Reporting Standards, for example.

While the appropriate practices are still developing, many foundations have adopted the approach of treating programme-related investments (PRIs) as grant-making and mission-related investments (MRIs) as investing. The application of this approach will depend on how likely the PRIs are to generate returns. For example, a portfolio of small interest-free loans to programme beneficiaries may be fully anticipated to be repaid and therefore should be seen as financial instruments and recorded as an asset. However, where the loans have a very low probability of generating returns, they may best be seen as a grant. Where the exposure is somewhere in between these extremes, they can be seen as an asset which is "fair valued" regularly to reflect the probability that there will be a cash flow linked to it. This approach can also be used for instruments that have cashflows tied to the achievement of impact metrics.

For PRIs, some foundations create convertible instruments that start as a grant but then can become an asset in certain conditions (discussed in Chapter 3). These are known as "recoverable grants" or "convertible grants". In such cases, the foundation has an agreement with the recipient that the grant will be repaid if the recipient hits certain targets, or converted to equity or debt that will become an asset for the foundation. If it is convertible, the foundation would record an asset on its balance sheet post the conversion.

Social impact bonds (discussed in Chapter 3) are another complex issue for accounting, as they can include both grant and investment instruments (see example box). A foundation can be an outcomes funder, in which case it must pay if outcomes are achieved, but it can also be an investor that provides loan funding or other investments to the implementation partners responsible for programmes that generate the outcomes. It can therefore be both an investor and a grant maker to a single programme.

Example: TUTUWA'S INVESTMENT IN THE IMPACT BOND INNOVATION FUND

When Standard Bank Tutuwa Community Foundation, a foundation set up as part of Standard Bank's empowerment deal, made the decision to invest R3.5m in one of the first social impact bonds (SIBs) in the country, it put considerable effort into thinking through the appropriate accounting treatment. Investors put money into the SIB, but the returns they earned would depend on its performance in meeting the impact objectives (Intellidex, 2021). The SIB was designed to improve the early childhood development of preschool children. There were three targets for outcomes: a recruitment target, an attendance target, and performance through a standardised test. A component of the returns to investors was tied to the test results. The better the programme beneficiaries did, the higher the return to investors, up to 16% per year.

Tutuwa, with advisors from the bank, determined that the best approach was to see the investment as a financial asset (in line with the accounting standard called IFRS9) and then to fair value it at accounting dates, based on the probability of returns at that point. The team built a valuation model for the key variables that affected returns in order to calculate the fair value on each accounting date. Fair value is an accounting concept for the value a normal marketplace participant is willing to pay for an asset in an open market.

MRIs are more straightforward to account for as part of the asset side of the balance sheet. While the portfolio is typically managed by a fund manager who can provide regular reports on the value of assets, some foundations that take on the task of managing investments directly will need to ensure they apply appropriate valuation principles for assets. Particularly in the case of unlisted debt and equity, valuations can be subjective.

These issues may require that a foundation seek the advice of accounting specialists with impact investing experience in determining their approach to the financial management of an impact investing strategy. There can be complex issues to consider, particularly when the investment is a hybrid or conditional type instrument.

Tax

One common concern for foundations is how impact investing can affect their tax status. Tax is a complex area, and impact investing is a relatively new activity with little established precedent for tax treatment. We discuss in this section some of the different approaches that can be used for impact investing. Foundations that are developing their strategy can seek comfort by asking the SA Revenue Service (Sars) for non-binding opinions on the tax consequences of their plans. The non-binding opinions are not a guarantee of how Sars will treat a certain activity, but it does provide an indication of how Sars believes an activity should be treated.

Foundations' PBO status

There are two legal forms that a foundation typically takes: a non-profit company or a trust. These, as well as common law "associations of persons" and local branches of foreign tax-exempt entities, may apply to be registered as public benefit organisations (PBOs) in terms of Section 30 of the Income Tax Act. This allows organisations to gain exemption from income tax, which, even though non-profits do not generate a surplus, is important for the process of accumulating reserves and managing contributions. Some may further register under Section 18A of the Act which allows for donations to the PBO to be tax exempt, meaning that donors don't have to pay donations tax (of 20%) and can treat the payments as a tax-deductible expense. Others may alternatively register as small business finance entities (SBFEs) which also receive favourable tax treatment and are useful for PRI portfolios of loans to small businesses (but don't benefit from Section 18A in respect of donations made).

The act as currently drafted caters for typical charitable activities (public benefit activities, PBAs, listed in the Ninth Schedule of the Act) and does not envisage impact investing. Those organisations registered as PBOs are required to ensure their PBAs are their "sole or principal object" and carried on "in a non-profit manner and with an altruistic or philanthropic intent". A PBO can engage in "investment of surplus funds" which is tax exempt, but there is a lack of clarity regarding permissible investment activities by a PBO.

Sars' guide to PBOs states: "Surplus funds may be accumulated or invested for future use in carrying on its sole or principal object," where those principal objects are public benefit activities. There is a risk that Sars may deem impact investing to fail this test because the investing has a purpose in its own right, not merely to save money for future use in carrying on the principal object. The wording simply does not anticipate the possibility that the investment has any purpose other than to generate returns for spending on PBAs. However, in Krutham's view, impact investing is squarely aligned to the "sole or principal object" of the PBO as it is merely a tool to use in delivering the public benefit activities it pursues, although Sars has not explicitly given guidance.

In terms of partial taxation rules (Section 10(1)(cN) of the Act), a PBO is exempt, except for receipts and accruals that are derived "otherwise" from a business undertaking or trading activity. The balance of activities, in other words, is taxable. There are, however, some exceptions. One is that the business undertaking or trading activity is "integral and directly related" to the sole principal or object of the PBO, is directed towards cost recovery and must "not result in unfair competition" with other entities engaged in taxable activities. The unfair competition clause indicates that PBOs should not use their tax status to compete against tax-paying firms, given that they would have an unfair advantage in being able to keep profits tax-free. Another is if the PBO's receipts and accruals from a business undertaking or trading activity are capped at the greater of 5% of total receipts and accruals, or R200,000, which is deemed sufficiently minor to not detract from the sole or principal object.

It can be argued that both PRIs and MRIs can be "integral and directly related" to the sole principal or object of the PBO, depending on how the investment policy statement is worded and the wording in the memorandum of incorporation of the PBO. For example, if a foundation's purpose includes innovating financial instruments to support skills development to reduce unemployment, impact investing could be seen as part of its sole object. Several foundations in South Africa have taken this view. Some foundations have sought a non-binding private opinion from Sars before committing to impact investing which has supported their approach.

SBFEs as an alternative approach

For impact investors who choose to build and manage portfolios themselves, another option is to consider the dispensation for small business funding entities (SBFEs), also provided through the Income Tax Act. Similar to PBOs, these are non-profit entities specifically for making loans to small businesses and are also exempt from income tax and capital gains tax (though they do not benefit from Section 18A which allows for tax-free donations to them). Their "sole or principal object" needs to be funding to SMMEs "on a non-profit basis and with an altruistic or philanthropic intent". SBFEs can borrow funds themselves, so they can serve as an appropriate subsidiary vehicle for a foundation, which then lends money to the SBFE to fund it.

There is ambiguity around whether mentoring and other support to small businesses would conflict with the object of the SBFE, though it is logical that it would not and most SBFEs work on that basis. SBFEs can make loans to businesses with a turnover of up to R20m at the time of the loan.

What could the tax costs be?

Any risk, though, is limited to being deemed to be liable for income tax on those parts of a foundation's activities that are deemed to generate trading revenue. This would be the component above the 5% or R200,000 allowed, and income tax would be raised only on the component of the foundation's income related to the trading activities. For example, a foundation whose income in any one year was derived 20% from impact investing returns that were deemed to be trading activities, would at most face income tax on 15% of its income (ie, that part of the returns in excess of the 5% allowed for returns from a business undertaking). The risk of completely losing PBO status would arise only if a foundation was deemed to be wilfully engaging in trading activities that are outside of its core purpose. Sars has not set clear criteria for how to assess whether an organisation's "sole or principal object" is the established public benefit activities. This tax ambiguity creates uncertainty which does hold back impact investment, and several parties that are working to improve the impact ecosystem are funding research on improving the policy environment (see FirstRand example).

PBOs are also fully able to own for-profit subsidiaries. Some foundations have therefore taken the approach of incorporating a for-profit subsidiary that manages its impact investments and is taxed accordingly. Such a subsidiary can generate dividends that flow into the endowment of the PBO and can be funded by a loan from the PBO. Similarly, a PBO can also register a subsidiary SBFE to undertake small business investing that qualifies under SBFE requirements.

Another mechanism, particularly in the case of MRIs, is to use third parties to manage the mission investing portfolio, much like an asset manager that manages the main endowment portfolio. In such circumstances, risks are reduced as the PBO would not be engaging in a trading activity or business undertaking. Some specialist fund managers can provide portfolios that closely align with the mission of the foundation. This can include client-directed investment decision-making, where clients are directly involved in assessing potential investments, but the management of the portfolio is undertaken by the third party.

Again, specialist advice can be obtained from tax lawyers and other tax specialists who have experience in impact investing and non-profit entities.

Licensing considerations

Financial services firms are heavily regulated to protect the public from abuse and to maintain financial stability. There are many stories of investment scams that provide ample warning that things can go wrong. As a result, firms and individuals providing investment advice and services are regulated under the Financial Advisors and Intermediary Services (FAIS) Act by the Financial Sector Conduct Authority. This does not ordinarily apply to investors who are making investments in public or private companies (as they would be principals, not intermediaries), but if you act as an intermediary in advising either an investor or recipient of investment, you may be required by the legislation to register as a financial services provider. We have not encountered foundations that have registered as a financial services provider, though it is worthwhile examining to see if any service providers you obtain advice from should be registered.

Foundations that set up their own lending activities, whether through an SBFE or otherwise, could become subject to the National Credit Act. Loans of any amount under R1m that earn interest are subject to the act. This can mean that an impact investor making small loans must register with the National Credit Regulator, and some SBFEs have done so. This is not a particularly arduous process but does increase reporting requirements on the SBFEs, which must file returns.

Key questions to consider from this chapter

How does the regulatory environment aid or hinder the foundation's ability to embark on impact investment?

What will your strategy be for managing regulatory risk?

conclusion

Conclusion

We hope this handbook provides you with a practical set of tools to use in developing an impact strategy. Such a strategy should help deliver the impact that foundations seek. Impact investment presents an opportunity to improve outcomes for societies in which foundations operate, stimulating sustainable solutions for intractable social problems. It can also increase the longevity of their capital, generating revenues that can be reinvested and leveraged to generate further impact over time. This simply can not be achieved with grants alone.

Given the relative newness of impact investing, many foundations are on a learning journey. We have aimed to draw out the lessons that have been accumulated so far, but there is a constant process of learning by doing and collaborating with others which can help share knowledge and overcome challenges.

Foundations that embark on impact investment will need to make a deliberate effort to refine impact objectives and theories of change and may need to make changes to internal structures and systems to achieve impact targets. They must consider existing resources and the foundation's mission should inform the design of the overarching approach to impact investment.

However, foundations bring many important capabilities to the impact investing environment. They are generally highly experienced in developing programmes that achieve positive change. Their ability to track that change is valuable in an impact investing context. Using the tools of investment to drive change is about adding to the foundation's set of capabilities, not changing the mission.

Globally, foundations have been at the vanguard of impact investing. The term was first coined at an event hosted by the Rockefeller Foundation in 2008 (Wood, 2020), and today foundations such as the Ford Foundation and MacArthur Foundation are pioneering impact investing approaches that are catalysing vast amounts of investment towards achieving social goals. For South Africa, the benefits of using impact investing by foundations to crowd in significantly more financial resources could help deliver far greater change. Foundations here can lead this evolution.

This does require foundation staff to learn some new skills. We have written this guide to serve as an important resource in that process. There are many more resources available (some of which we provide in the appendices below) and many organisations that will support foundations in developing these capabilities. But it is also true that the finance sector is learning new lessons about how to develop and monitor the impact of their activities. The two worlds of philanthropy and finance, which have historically seemed worlds apart, are beginning to find each other. Impact investing is the common ground on which they can collaborate and share knowledge.

We wish you well with your impact investing journey.

APPENDIX 1

About Impact Investing South Africa

ABOUT IMPACT INVESTING SA

Impact Investing SA is the National Partner to GSG Impact - a global network of National Partners that collectively advances impact investing. It is a cross--sectoral initiative that acts as an ecosystem facilitator to accelerate the deployment of capital that optimises financial, social and environmental returns. This is achieved through four volunteer-based working groups, each of which consists of subject matter experts.

IISA working groups

FOUNDATIONS

To increase local foundations' engagement with impact investing by way of their grant/ catalytic capital as well as their endowments

IMPACT MEASUREMENT & MANAGEMENT

To enable investors to make better investment decisions for people and the planet as a result of improved non-financial or impact reporting

IMPACT CAPITAL SUPPLY

To increase quantum of impact capital across asset classes and the risk-return spectrum

DEMAND SIDE

To support the development of a pipeline of businesses seeking to address challenges associated with the with the National Development Plan 2030 and the UN's sustainable development goals

Since its inception in 2019, the Foundations Working Group for **IISA** has worked towards achieving the strategic objectives set out by the board:

1. **Increase the supply of capital available for high-impact enterprises and projects through foundations by addressing the constraints currently limiting foundations' uptake of impact investing strategies.**
   - Increase the total supply of capital that is demonstrably spent on enterprises and projects that directly address South Africa's National Development Plan 2030 and the UN's 17 sustainable development goals.
   - Increase in the amount of capital across the risk-return spectrum, particularly patient, flexible and risk-tolerant capital.
   - Increase the number of foundations that use their investment capital for impact investing strategies.
2. **Create an enabling environment to increase the deployment of impact investment**
   - Increase the number of foundations supporting the development of impact investing.
   - Increase the supply of capital to market-building initiatives.
3. **Increase the use of outcomes-based contracts and outcome funds**
   - Increase the use of pay-for-performance and outcomes-based instruments including social impact bonds.
   - Build a national outcome fund (eg, Foundation Phase Literacy Fund linked to Africa and Middle East Education Outcomes Fund).
   - Leverage public sector and international funding for outcome funds.

This handbook aims to contribute to all three of the above objectives by supporting foundations on their impact investing journeys, ultimately increasing the amount of impact investing capital deployed in the local market and possibly also increasing participation in outcomes-based funding models. Its development has been made possible by three South African foundations that have been market leaders in the impact investing space: the SAB Foundation, Standard Bank Tutuwa Community Trust and First Rand Empowerment Foundation.

APPENDIX 2

Further reading

1. Mission Investors Exchange is a US-based impact investing network for foundations, philanthropic asset owners and their partners. MIE offers resources, inspiration and connections to empower members to expand their efforts in deploying capital for social and environmental benefit. *https://missioninvestors.org/*
2. Developing an Impact Measurement Framework is a step-by-step guide to developing a successful impact measurement framework. *https://investmentimpactindex.org/wp-content/uploads/2020/05/III-A-short-guide-How-to-develop-an-impact-measurement-framework-Digital.pdf*

Other handbooks and guides

While this guide has been developed specifically for South African foundations, several other resources could support foundations on their impact investing journey.

Guide	Brief overview	Who is this for?
Toolkit for Foundations that want to do impact investing	A basic, introductory guide developed for foundations in Spain that provides a high-level overview for developing an impact investing strategy.	Foundations that are starting on their impact investing journey.
Essentials of Impact Investing: A Guide for Small-Staffed Foundations	This is a comprehensive technical guide that details the process for foundations to design and implement an effective impact investing strategy, covering topics from engaging trustees and developing an impact policy, to deal sourcing and due diligence and impact measurement and management.	This guide is for small foundations with limited resources and will be particularly useful for family offices. It provides practical advice for foundations at each step of their impact investing journey.
Evolving your endowment: Driving change through impact investing	A detailed guide on investing in endowments developed for UK foundations that provides practical steps on setting a strategy, writing an impact-enabling investment policy statement, selecting the right partners to work with and managing relationships.	For charitable foundations that want to align their investable assets for impact, ie, investing their endowments (mission-aligned investing).
Impact Investing Handbook: An Implementation Guide for Practitioners	This handbook was developed to help asset owners who are interested in impact investing to transition into action. It is a practical guide with detailed guidance and case studies.	Developed for a range of stakeholders, including individuals, families, corporations and foundations.
The Impact Investing Guidebook for Foundations	A practical guide developed for Canadian foundations, including case studies, frameworks, conversations and a roadmap.	Executive directors and board members of foundations that are starting on their impact investing journey.
A short guide on impact investing	A basic primer to help individuals better understand how business can drive social change and create social impact.	An introductory guide for individuals who want to learn more about impact investing.

glossary

Glossary of terms

Please note that while many of these terms may be unfamiliar, those that are most important are explained in more detail in the body of the guide.

Actively managed – an approach to investing where the investor directly selects the companies that it invests in (as opposed to passive investments, where the investment tracks tracks a benchmark index).

Asset – a resource that has some economic value and can be used in a current or future period to generate revenue. There are different kinds of assets including buildings and equipment as well as shares.

Asset class – a category of financial assets that exhibit similar risk and return characteristics and are subject to the same laws and regulations. Examples of asset classes are equities/ shares, bonds (debt instruments), money market instruments (short-term debt that is generally treated as a cash instrument), real estate and commodities like gold and silver.

Angel investors – wealthy private investors focused on financing small business ventures in exchange for equity.

Below-market – can refer to any price that is lower than the current market price.

Bonds – an investment that represents a loan made by an investor to a borrower, usually a government or company. The bond is a financial instrument that captures the obligations of the buyer and seller and can often be bought or sold on an exchange. For example, a government wants to raise money to build a dam. It therefore issues multiple bonds which investors can buy, and it agrees to pay back the loan with interest by a certain date. Those purchasing the bonds get a fixed rate of interest and their capital back.

Cash flow – the movement of cash in and out of a business. This is a very important part of a business to understand as it is one of the leading reasons why businesses fail. For example, a small basket weaving business gets an order from a leading retailer for 500 units. To make the order, it must have enough money to pay for all the materials as well as pay operational expenses and wages. In addition, many big retailers only pay 90 days after receiving the merchandise. Therefore, for many months, there will be significant cash leaving the business (cash outflow) before it is paid for the order (cash inflow).

Capacity building – the process of developing and strengthening skills, processes and resources that organisations and communities need to survive, adapt and thrive in a fast-changing world.

Capital – a term used in financial services for money or funding that is available for investment.

Capital markets – financial markets that bring buyers and sellers together to trade stocks, bonds, currencies, and finance assets for example, the Johannesburg Stock Exchange.

Catalytic finance – a type of financing that seeks to create positive social and environmental impacts in addition to generating financial returns. The term "catalytic" refers to the ability of the initial financing to attract additional investments, leading to a multiplier effect that creates even greater positive impacts. Without catalytic financing, a project may not be funded at all or in a different and less impactful way.

Commercialisation – the process of bringing new products or services to market.

Commercial investors – investors that prioritise generating a financial return, for example an investment fund that aims to maximise financial returns for its clients.

Concessionary finance – funding that is subject to below-market return (eg, low interest loans).

Development aid – a type of foreign aid given by governments and other agencies to support the economic, environmental, social and political development of developing countries.

Debt – is a sum of money that is owed and a form of finance that receives a fixed yield or interest payment. Debt incurs fixed costs no matter the performance of the borrower. For example: If a company borrows money, it will need to pay it back with interest at regular intervals. It will therefore need to make enough money to afford those repayments. For more experimental projects where cash flows are uncertain, debt can be ill-suited but can boost returns for projects with clear and reliable cashflows.

Development finance institutions (DFIs) – also known as development banks, are financial institutions that provide risk capital for projects that commit to developmental mandates for example the Industrial Development Corporation and the African Development Bank.

Equity (or shareholder equity) – refers to ownership in a company and the value of that ownership. It is the assets of the company (like cash, premises and inventory) minus the liabilities (like money owed to banks and suppliers). This equity is held by shareholders through instruments known as shares – called that because they represent a "share" of the equity of the company. Equity can be raised from shareholders by issuing new shares to them in return for cash. Shareholders earn a yield on their shares in the form of dividends, which is money a company chooses to pay out to shareholders when it has generated profits and has sufficient cash available.

Fair value – is a rational and unbiased estimate of the potential market price of a good, service or asset. It can be easily determined if the asset is traded on a liquid market like a stock exchange, in which case fair value is the same as price. But when it is not traded on an exchange, or there is so little trade in it that the price probably doesn't reflect fair value, estimates of fair value have to be made. In principle, it's the price at which an asset or security should theoretically exchange hands between a willing buyer and a willing seller, assuming both parties are well informed and acting in their best interests.

Fiduciary duty – the legal responsibility to act solely in the best interest of another party.

Financial structure – this refers to the different sources of funding that a company has to finance its operations. The main types of funding are debt and equity. For example, a company may choose to fund itself using 50% debt and 50% equity. Companies will balance the debt and equity ratio by how risky the outlook for the company is, increasing debt if it is low risk, and increasing equity if the risks are higher.

Grant-making – the awarding of grants, often distributed to nonprofit organisations and initiatives.

Grants as a sunk cost – grants that represent money spent and cannot be recovered by institutions.

Gender-based investing – also known as gender lens investing, is an impact investment strategy that combines pursuing financial returns with promoting gender equality and social well-being. It involves investing in women-owned or led enterprises as well as enterprises that promote gender equality in the workplace.

Impact investing – the deployment of funds into investments that generate a measurable and beneficial social or environmental impact alongside a financial return on investment.

Internal rate of return (IRR) – a metric used in financial analysis to estimate the profitability of potential investments by estimating the future cash flows and determining the discount market rate that makes the present value of those cash flows equal to zero. IRR is often used to determine whether a project is financially viable by assessing whether it is higher than some hurdle rate, for example, the cost of capital for the project.

Investment policy statement – describes an investor's financial goals and investment objectives, while documenting the roles and responsibilities of all parties involved in managing portfolios.

Investment risk – the risk that returns from an investment, whether it is buying shares or lending money to a company, will be different to those expected, either higher or lower. Investors are generally more concerned about downside risk, which is the risk of losing some or all of their money.

Liquidity – the ability to sell an asset rapidly. Investors like to have the option of being able to convert assets into cash quickly, with cash itself being the most liquid kind of asset. That provides them with some protection in case of an urgent need for cash. Assets like property or vehicles can be sold but will take some time to dispose of. Listed shares in large companies are usually highly liquid and can be sold almost immediately. Companies can be solvent in the sense that their assets are worth more than their liabilities, but still be bankrupted if they must pay liabilities before they can sell their assets to raise cash.

Listed investments – these are investment interests that are listed on a stock exchange. Equity instruments are generally in the form of listed shares, while debt investments are generally in the form of listed bonds. There are several kinds of hybrid instruments that can be listed such as preference shares, which have a cap on the dividend that can be paid making them somewhat like debt, but also might not be paid at all, making them somewhat like equity. There are several other kinds of listed investments, including exchange-traded funds, which are portfolios of other investments that can be traded on an exchange.

Loan guarantees – a legally binding commitment from an institution to cover the debts of a borrower in the event that they default. For example, a foundation may guarantee a loan made by a bank to an innovative social enterprise to develop a new medical breakthrough. If the social enterprise fails, the foundation will step in and repay the bank.

Loans – a sum of money that can be borrowed from banks or other financial institutions that has to be paid back with interest. Used interchangeably with debt.

The market – a concept referring to the collective of all buyers and sellers in the financial markets. When markets move in a clear way, for example share prices rise because of the release of positive economic growth data, this is often described as "the market" having a positive response to the data.

Microfinance – a lending service in the form of small loans provided to low-income individuals or groups, for example the Grameen Bank in Bangladesh or the Small Enterprise Foundation in South Africa.

Patient funding/capital – another name for long-term capital. Here, the investor is willing to make a financial investment in a business with returns only emerging in the distant future, for example

investing in a medical start up where a lot of clinical trials need to take place before it can begin generating revenue.

Philanthropy – the desire to promote the welfare of others, expressed especially by the generous donation of money to good causes.

Place-based investments – investments with a specific geographic focus.

Portfolio – a collection of assets like shares and debt instruments. A portfolio is how investors spread their risk, ensuring, for example, that they have investments in several companies and not just one, so that if any one company fails, it can be balanced out by the returns in the rest of the portfolio.

Portfolio manager – a professional responsible for making investment decisions and carrying out investment activities on behalf of individuals or institutions.

Private markets – refers to investments made in assets not traded on a public exchange or stock market. These can still be bought or sold but must be between a buyer and seller without an exchange operating to match them.

Public funding – the allocation of financial resources by government entities to support programmes, services, and initiatives that are aimed at addressing societal needs and promoting general welfare.

Public markets – refers to stock and bond markets such as the Johannesburg Stock Exchange, or the Nasdaq, where companies and other institutions including governments, can list their shares and debt instruments for investors to buy and sell.

Pre-revenue - refers to the stage of a company's development when it has yet to generate any revenue, in other words, it is not yet trading.

Revenue – A term used in financial services to describe income derived from selling a good or service.

Risk – the chance that things won't turn out as expected. Note that in finance, risk refers to both surprises on the upside and on the downside, even though we generally think of the risk of losing money (the downside) as the real risk. Generally, equity is considered higher risk than debt because equity investors are only paid out after all debts have been settled. For example, a company may be financed by a bank loan as well as money contributed by its founders. If the company succeeds, the founders will benefit from the profits, but if it fails, the bank must be paid back first. The bank loan, a form of debt, is therefore lower risk than the shares that the founders hold.

Risk capital – money or assets that risk a loss in value. Whenever an investor is putting money at risk of being lost, for example by buying the shares that a company issues, they are providing risk capital to the company. This can be contrasted with "safe capital" such as money deposited in a bank or invested in government bonds.

Risk-adjusted returns – a measure of returns that factor in the risk that those returns face. Usually this is measured by examining the volatility of cash flows. An investment that is expected to provide a reliable stream of cash flows like a bank deposit can have higher risk-adjusted returns than an investment with a highly uncertain cashflow outlook like a mining exploration venture that may not discover mineral reserves.

Risk-return profile – any investment presents the opportunity for returns as well as risk. These balance against each other – investors only take high risk if they believe there is a chance of high returns. There is therefore a trade off between risk and returns and the risk profiles of different asset classes shows this relationship. Typically, a higher return investment also comes with high risk and the risk return profile will show this trade-off. For example, high-risk investments like shares typically offer the potential for higher returns, while low-risk investments like government bonds offer more stability but lower potential returns.

Risk-tolerance – a measure of the degree of loss an investor is willing to accept within their portfolio. Typically, an investor that can afford to lose their investment is said to have a higher risk tolerance than an investor that depends on their investment for their livelihood.

Social enterprise – an organisation that uses commercial strategies to achieve social, environmental, or community objectives. They prioritise social impact, reinvesting profits into their mission to address societal issues such as poverty, education, healthcare and environmental sustainability.

Social impact bonds – are financial instruments designed to fund social programmes in which investors earn a return that is a function of the social outcomes that are achieved. They operate as partnerships between governments, private investors, and service providers. For example, the Bonds4Jobs SIB in South Africa, paid investors a return if jobs were created for young people.

Systemic change initiatives – include efforts to reform educational systems, transform healthcare delivery, address climate change through comprehensive policy frameworks and create equitable economic systems.

Unlisted investments – refers to investments that are traded in private markets, for example private equity or debt. These can include equity and debt instruments that are not listed on any securities exchange.

Venture capital – investment focused on the early stages of companies, usually before they are generating a profit and still developing the ideas that they will later use to make money. Venture capitalists provide investment in equity or debt as well as technical, or managerial expertise to startup firms with long-term growth potential. Many of their investments will fail, but some will generate high returns.

Yield – refers to the income generated by an investment, typically expressed as a percentage of the investment's cost, current market value, or face value. For example, a bond deposit paying interest of 10% will have a yield of 10%. Share investments that receive a dividend will also have a yield that is expressed as a percentage of the share price, for example a share worth R100 that pays a R5 dividend will have yield of 5%.

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