The Double Delta of Impact Investing: Impact at both the investor and company level.
Our commitment to the SDGs

The 17 Sustainable Development Goals (SDGs) adopted by the United Nations in 2015 form a core element of the UN Agenda 2030 for Sustainable Development. As the SDGs are based on a participatory process, responsibility for achieving them is shared among states, the private sector, the scientific community and civil society. Credit Suisse contributes to the realization of the SDGs in various ways, including in our role as steward of clients’ capital, as a global citizen, and as a principled employer.

We deliver this ambition through such activities as sustainable, impact and SDG-oriented thematic investment products and services, and through our philanthropic activities targeting education and financial inclusion. At the same time, our focus on sustainability risk management can help us to reduce potential negative impacts that certain business activities might have on the realization of the SDGs.
The Double Delta of Impact Investing: Impact at both the investor and company level.
At the company level, companies delivering the solutions we need to achieve the United Nations Sustainable Development Goals (SDGs) by operating in impact-aligned industries, such as education technology, financial inclusion, green technology or healthcare, are a good starting point. In principle, they are easiest to measure, because the sector they operate in has an inherent impactful mission at its core.

For companies operating outside these sectors, we can also look at the impact of a company’s products and services on the world. This can be more difficult to measure and to capture all externalities, but it presents another impact lens to the investor in evaluating where to deploy values-driven capital.

While most investors attempt to measure impact from these perspectives – analyzing the impact of a company’s business model, its operations or products – rarely do investors look at the power of their investment capital in its own right to drive change.

This paper is the second in the Exploring Impact Series, examining developments in the sustainable and impact investing sector, and attempts to distinguish between different impact strategies and impact evaluation methodologies.

In Part 1: Exploring Impact Series: From ESG to the SDGs, we covered the shift in the market from concentrating solely on company ESG processes and policies, to looking deeper at company level to explore the impact of a company’s products.

Here in Part 2 of the series, we further probe company contributions to actively helping solve the world’s most pressing challenges, assessing how to evaluate their impact, and examine how investors can gain exposure to these companies. We go beyond company-level only analysis to explore how to evidence change (or Delta) at two levels: company level (Delta 1) and investor level (Delta 2).
Delta 2 level, at its heart, is about the investor’s ability to create high-impact outcomes. Investors can do this by allocating capital to high impact companies and projects in private equity and debt where their patient capital is a key factor in being able to achieve the desired outcomes, but investors can also create real impact through active ownership. Both of these strategies deliver Delta 2 impact.

At Credit Suisse, we see sustainable investing as a spectrum that covers a variety of investment strategies and approaches. Our clients want solutions ranging from ESG strategies of exclusions and integration, through to thematic and impact-aligned, all the way to deep impact investing, each delivering different outcomes and varying levels of values alignment and impact.

We recognize that not everything in an investment portfolio needs to be a high-impact strategy. There is an important role for exclusions, ESG integration and thematic approaches in a well-diversified portfolio. In fact, high-impact strategies will likely only ever represent a small percentage of the portfolios of most clients, as they typically fall into alternative asset classes – and that’s OK. But where we classify an investment opportunity as “impact”, we are committed to delivering demonstrable, measurable impact, and to reporting outcomes in a transparent and open manner, so that investors can understand the power of their capital to drive change.

Generating returns. Sustainably.

Marisa Drew
Chief Sustainability Officer
Global Head of Sustainability Strategy, Advisory and Finance (SSAF)
Credit Suisse

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At Credit Suisse, we see sustainable investing as a spectrum that covers a variety of investment strategies and approaches.

This paper builds on Part 1 of the Exploring Impact Series: From ESG to the SDGs. We focus on investor level impact, how investors can evaluate investments and increase the likelihood of delivering real impact.

From ESG to the SDGs: The shift from process and policies to delivering positive contribution.
Introduction

Sustainable investing has a long history and has evolved considerably in recent decades. While there are many different approaches, the industry unites around three overarching sustainable strategies - exclusions, ESG integration, and thematic and impact investing - each with different motivations and purposes, and with different functions within a portfolio.

1. **Exclusions**: The primary purpose of exclusion strategies is to provide investments that align with client values, and typically involve the exclusion of firms or sectors that produce so-called “sin products” such as tobacco, alcohol, adult entertainment and weapons manufacturers. These strategies can also exclude companies that violate human rights, breach UN norms or cause severe environmental damage. Implemented traditionally in public market fund strategies, these can easily replicate traditional benchmarks and passive strategies.

2. **ESG integration**: ESG strategies integrate material environmental, social and governance (ESG) factors into investment processes for delivering superior risk-adjusted returns. Catalyzed by the launch of the UN Principles for Responsible Investment (UN PRI) in 2006, ESG integration focuses on how risk and opportunity around environmental issues, human capital, human rights, supply chain management, corporate governance and other issues can be material to the financial prospects of companies, and how they should be considered for mainstream investment processes. They are applied most explicitly in active management, where ESG issues are part of the fundamental analysis of a company.

3. **Thematic and impact investing**: The purpose of thematic and impact investing strategies is to mobilize capital into companies that offer solutions to society’s challenges. There are two sub-categories:
   - **Thematic and impact-aligned**: In recent decades, sectors such as education, healthcare and clean energy have grown strongly, and fund managers have set up thematic funds to invest in these companies in both public and private markets. Interest in investing in solutions has grown considerably since the launch of the SDGs and mainstream investors are now exploring how they can proactively mobilize capital towards the SDGs. While ESG integration strategies focus on the sustainability of the company’s operations and processes, thematic and impact-aligned strategies focus on investing in companies whose products and services are inherently impactful.
   - **Impact investing**: Coined by the Rockefeller Foundation in 2007, impact investing describes sustainable investing strategies with the intention to deliver measurable impact. A key element of impact investing is investor contribution or additionality. This is the idea that the investment into a company, or the “value add” investors can bring to a company, generates more impact than if they had not invested. Impact investing has primarily focused on private market investments, early stage or developing country companies.
Different strategies play different roles in a portfolio; not everything needs to be highly impactful. If a client wants to create a sustainable portfolio, replicating a conventional one from a risk/return perspective, it would probably include a majority of assets classified as exclusion and ESG integration, a minority in high-conviction thematic strategies, and a smaller minority in impact investments (such as private equity or debt). For these (typically smaller) allocations, where investors really want to make deep impact, we need to be able to identify and implement the strategies likely to deliver that impact.

This paper pulls apart the two dimensions of impact that need to be maximized – the impact the companies make (Delta 1) and the impact that investors into those companies can make (Delta 2) – and focuses on how to evaluate and enhance the latter.

We feel that this level of analysis, when conducted in a robust way, will lead to better decisions and greater impact on the world.

Dr. James Gifford
Head of Impact Advisory
Sustainability Strategy, Advisory and Finance (SSAF)
Credit Suisse

We are yet to evaluate the impact that investors themselves are making through their investments.
Credit Suisse’s approach to sustainable investing

Sustainable investing as a spectrum covers a variety of investment strategies and approaches. Sustainability Strategy, Advisory and Finance (SSAF) aims to deliver solutions - ranging from ESG strategies or exclusions and integration, through to thematic/impact-aligned and impact investing - that are focused on market rate of return for the given opportunity.

In this paper, we delve deeper into the impact investing section of this spectrum, which contains the highest-impact investments.
### Credit Suisse’s sustainable and impact investment focus

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<td>Return first</td>
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#### Delivering competitive financial returns
- Limited or no consideration for environmental, social or governance aspects in the investment approach
- Systematic avoidance of exposure to controversial business areas or unethical behaviour
- Norm-based exclusions
- Values-based exclusions
- Country exclusions (sanctions)
- Exclusions based on business conduct (UN Global Compact breaches)

#### Mitigating environmental, social and governance (ESG) risks
- Consideration of financially material ESG risks and opportunities
- Based on industry-specific sustainability expertise
- Reflects the Credit Suisse house view on ESG topics
- ESG integration in investment processes in combination with financial analysis
- Approach adapted to asset class, product characteristics and investment objective

#### Pursuing environmental, social and governance (ESG) opportunities
- Participation in sustainable growth themes
- Contribution to the Sustainable Development Goals (SDG)
- Alignment of investor and enterprise mission to generate impact
- Address societal challenges that generate competitive financial returns

#### Focusing on measurable high-impact solutions
- Impact investing fully compliant with the IFC Principles
- Clear and direct investor contribution to the impact of the enterprises via financing growth or active ownership
- May include models where the risk and return to investors may be blended i.e. catalytic capital to crowd in for profit investors

- Address societal challenges that do not ask to generate a financial return
The “Double Delta” of impact investing

There has been a dramatic increase in interest in impact investing, and aligning investments with the SDGs.

Much of this discussion – and almost all the debate around metrics – is at the company1 level. To what extent are these companies delivering sustainable and impactful change (Delta) to society and the planet?

This focus on the impact of companies is an important development; exclusion strategies focus on what not to own, while ESG integration strategies focus on how we leverage material ESG issues to achieve superior risk-adjusted return.

While the sustainability of companies producing “regular” products and services is important, innovative companies addressing specific solutions, such as access to water, clean energy and healthcare, are more likely to solve the world’s most pressing problems. The increased focus on the ultimate impact of the products and services - and not just the sustainability of production processes - is a welcome evolution. There are now funds that focus on offering clients exposure to these impactful companies. See Part 1 of the Exploring Impact Series: From ESG to the SDGs for a deep dive into these developments.

As investors, we also need to explore the impact of different impact investment strategies. How can they create impact? In which stages of a company’s lifecycle is investment most impactful? How can investors add value to the company in terms of additional impact during the investment period?

Investors have the greatest impact when they help fund the growth of impactful companies where that capital is additive or additional, as is often the case with innovative early-stage companies, or companies in developing countries (where capital is scarce and expensive). Investors can also be highly impactful when they are active owners, and influence companies through joining boards, becoming trusted advisors to the company management, or by exercising shareholder rights, resulting in improvements or changes in corporate sustainability performance.

We therefore differentiate two levels of impact:

- Company impact (Delta 1): the positive impact/change a company generates through its products and services
- Investor impact (Delta 2): the positive impact/change an investor generates, through enhancing the quality/quantity of the impact a company is generating by financing or active ownership.

This paper focuses on the investor layer (Delta 2), and how investors can evaluate and maximize their impact.

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1. In this publication, we use the term “company” to refer to businesses producing goods and services as opposed to entities financing these businesses.
Delta 1: The impact that companies make

Part 1 of the Exploring impact series *From ESG to the SDGs* explores impact at the company level in more depth, with a number of case studies and examples.

The Impact Management Project (IMP) has developed a global consensus on a high-level framework that defines the key dimensions of impact. An analysis of these dimensions can help investors evaluate likely impact of a company.

- **What** - How does the company expect to generate positive outcomes for people and the planet? How relevant are the targeted SDGs in a geography or sector, and are they important priorities? In a country with water scarcity, for example, a company offering innovative solutions to save water is highly relevant to where it operates.

- **Who** - What stakeholders will benefit from the positive outcome? How underserved are they in relation to the product or service offered?

- **How much** - What is the magnitude of the expected SDG-aligned outcomes, including the potential scale, depth and duration of the expected impact?

- **Contribution** - Do the company’s efforts lead to better outcomes than without its participation in that market? Contribution to the SDGs and a positive impact measures the additionality that we can attribute to the company’s activities.

- **Risk** - What can go wrong? What could be unintended negative effects of delivering the expected SDG contribution? For example, what is the risk of not meeting impact targets or other potential downside ESG risks or externalities?

Other important elements when assessing company impact include:

- Does the company have a strategy to deliver impact?

- Is there a clear theory of change in terms of the products and services and how they deliver impact?

- Does the team have the capabilities and governance to deliver the impact?

- Is the company measuring and reporting on its impact?

After evaluating these dimensions, investors can better assess a company’s likelihood of meeting its impact goals. Yet none of this analysis evaluates how investment itself contributes to impact generated. We a need to explore Delta 2: the impact that investors can make.
Delta 2: The impact that investors can make

The Global Impact Investing Network (GIIN) defines impact investments as “investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return”.

The promise of impact investing is that investors can drive capital into activities that are sustainable or that solve societal and environmental challenges, resulting in additional impact.

The initial aim of impact investing was to focus the broader sustainable investment community on transactions and strategies with demonstrable, measurable impact. While most SRI (Socially Responsible Investment) and ESG funds offered clients exposure to a more sustainable subset of public market securities, these strategies did not directly channel growth capital into companies, particularly at earlier-stages of their lifecycle or to those in developing countries. As a response, impact investing emerged to focus on the high-impact, private markets subset of the broader sustainable investment space.

Sustainable liquid investments have some impact in aggregate. Liquid ESG strategies have an important role to play as they shine a light on material ESG issues, and ensure a more efficient pricing of risks and opportunities around the sustainability performance of companies. They send signals to management that an increasingly significant proportion of the investment community cares about ESG performance and incorporates these issues into investment processes. We hope that these signals translate into greater attention to ESG issues from company management, and contribute to improving sustainability performance. These strategies also finance the ESG research industry, which has dramatically increased transparency and awareness about corporate ESG performance, both within companies and in the broader society.

However, there are vast differences in direct impact from these different investment strategies, and here we explore the spectrum of investor impact and the different approaches fund managers can take.

For Delta 2, the IFC’s Operating Principles for Impact Management (OPIM) is a key reference to help investors maximize and manage the impact that they can make.
We need to focus on the impact that fund managers (or other direct investors) can have through enhancing the impact of the underlying companies in which they invest, with a focus on Principle 3 of the OPIM – the fund manager’s contribution to the impact – as this principle is the key to ensuring investor impact.

**IFC Operating Principles for Impact Management**

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<tr>
<td>1. Define strategic impact objective(s), consistent with the investment strategy.</td>
<td>3. Establish the Manager’s contribution to the achievement of impact.</td>
<td>6. Monitor the progress of each investment in achieving impact against expectations and respond appropriately.</td>
<td>7. Conduct exits considering the effect on sustained impact.</td>
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<tr>
<td>2. Manage strategic impact on a portfolio basis.</td>
<td>4. Assess the expected impact of each investment, based on a systematic approach.</td>
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<td>8. Review, document, and improve decisions and processes based on the achievement of impact and lessons learned.</td>
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<td>5. Access, address, monitor and manage potential negative impacts of each investment.</td>
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**Independent verification**

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<td>9. Publicly disclose alignment with the Principles and provide regular independent verification of the alignment.</td>
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**Exploring impact series: The Double Delta of impact investing – Credit Suisse**

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Does an investor have the right strategy to deliver impact?

Intentionality at the fund manager level

Like impact-focused companies, intentionality is also important for fund managers. Strategic intent by investors is a key factor in successful impact investing, together with defined objectives. For many impact fund managers, intentionality is core, with investment opportunities viewed through the lens of both financial and impact returns.

However, intentionality isn’t necessarily a prerequisite for an investment or an investment fund to be impactful. Development Finance Institutions (DFIs), with a raison d’être to deliver impact, invest in both intentionally impact-focused, and traditional companies and funds in developing countries; their theory of change involves enhancing the capacity of the finance sector and responsible businesses in developing countries, which in turn supports economic development. They also work with mainstream funds to ensure they meet minimum ESG performance standards, and measure and monitor their positive and negative impacts.

Fund managers can also create substantial additional impact through active ownership activities. Yet without intention, a fund manager is unlikely to invest the time and effort to help a company enhance its sustainability and impact performance, or lead on more impact-oriented directions.

In addition, investors with a clear intention to create positive impact are likely to require impact measurement and reporting by their underlying companies. This is important in assessing whether a company is delivering the expected impact. Intentional impact fund managers also put in place checks and balances in investment agreements (primarily in private markets) to maintain mission focus, as companies may be tempted to drift or pivot towards less impactful strategies.

Impact investors can encourage traditional fund managers and companies to develop intentionality, and objective setting, measurement and reporting over time. An effective impact investing approach (routinely employed by DFIs) is to invest in strategies that may not demonstrate, initially, a clear intention around impact, and work with investees to build their capabilities to set impact and ESG objectives, measuring and reporting their achievements over time.

Intentionality is an important indicator in assessing the likelihood of delivering of impact, but it is not a prerequisite. The most important question is if investors deliver additional impact, and whether the impact is enhanced through investing in that company or fund.

2. See Principle 1 of the IFC Operating Principles for Impact Management.
Theory of change
Investors into impact funds need to evaluate whether a fund manager has a clearly articulated theory of change regarding their contribution to the impact of the investees. The contribution varies based on the fund manager’s strategy or approach to create impact, whether through capital allocation or active ownership, or a combination of both.

For example, some impact fund strategies invest in high-impact sectors (education, healthcare, access to finance, clean technology) and seek to grow them. Others (such as the DFIs) invest in non-traditional impact sectors in order to drive improvement or encourage higher standards, and their impact is the Delta they can create over time.

In liquid markets, where it is difficult to establish impact through capital allocation, the theory of change focuses on active ownership. Fund managers can invest in listed companies providing solutions to sustainability problems, and then engage to enhance the impact of these products and services. In addition, they might invest in “regular” companies with the goal of improving their corporate ESG performance, with impact based on improvement catalyzed in ESG metrics.

Team capabilities and governance of impact
Impact fund manager due diligence processes mirror those used for traditional funds i.e. assessing people, process, philosophy and performance to provide confidence that the fund manager can deliver on the investment strategy. However, with impact funds, there are additional steps taken to ensure that the fund manager is equipped to deliver impact.

Investors should assess how the fund management team’s incentives align with achieving impact. For example, a number of impact funds compensate their team, in part, based on the level of impact delivered.

For funds that invest in inherently impactful business models delivering high-impact solutions, the financial performance (e.g. growth) can be a proxy for impact achievement, and in those cases, the fund manager will incentivize the team based on traditional performance metrics.

In private markets, where a fund takes a significant share of a company’s equity, fund managers are able to set clear requirements for a company to meet ESG and impact standards and goals. In liquid markets, investors seeking impact should expect fund managers to have robust shareholder engagement and voting strategies to deliver attributable sustainability and impact outcomes - through company dialogue or filing shareholder proposals - and report on progress and any concrete outcomes on a regular basis.

Investors need to assess the credibility of the fund management team in terms of impact capabilities, and their capacity to deliver both impact and financial returns. As part of a due diligence, strong teams demonstrate their capabilities through a strong track record of delivering impact, and working for organizations with credibility in the impact space.

Obviam: linking carried interest to impact outcomes
Obviam manages private and public mandates, including the Swiss Government’s Development Finance Institution, SIFEM which invests into developing country private equity and private debt funds, including investing in first-time funds. They seek to invest profitably for improving livelihoods in developing countries and thus support inclusive growth. Obviam has developed an incentive system for one of its private clients that links the fund manager’s 10% carried interest entitlement, in part, to the achievement of goals such as implementation of ESG policies and job creation within investee companies.
How do investors create impact?

What are the actual mechanisms of impact available to investors? Fund managers or other direct investors create impact through financing, or enhancing the quality or quantity of the impact generated by their investee companies or projects.

Principle 3 of IFC Operating Principles for Impact Management asks investors to:

Establish the Manager’s contribution to the achievement of impact.
The [fund] Manager shall seek to establish and document a credible narrative on its contribution to the achievement of impact for each investment. Contributions can be made through one or more financial and/or non-financial channels. The narrative should be stated in clear terms and supported, as much as possible, by evidence. For example, this may include: improving the cost of capital, active shareholder engagement, specific financial structuring, offering innovative financing instruments, assisting with further resource mobilization, creating long-term trusted partnerships, providing technical/market advice or capacity building to the investee, and/or helping the investee to meet higher operational standards.

There are two main mechanisms of investor impact:

- **Capital allocation:** Investors create impact through directly financing the growth of impactful companies. They can also create impact through financing the upgrading or improvement of a company (from a sustainability or impact perspective). Allocating capital is most impactful in private markets, in particular at the earlier stages of a company’s lifecycle, as this when capital is most needed by a company and most difficult to access. Capital allocation is also highly impactful in developing countries or regions where capital is scarce. At later stages of a company’s lifecycle – when it is trading on a large, liquid exchange – there is little direct impact simply buying securities from others trading in that market.

- **Active ownership:** Investors can also create impact through “active ownership”, some of which are highlighted in the IFC Principles. These activities could include: adding value through participating on boards; offering technical assistance and strategic advice; providing access to networks; assisting with fundraising; and generally helping a company to enhance its sustainability or impact performance.

In listed equities, shareholder engagement – where fund managers engage in direct dialogue on sustainability issues with company management – is the key mechanism to deliver impact. The most public strategy is shareholder activism; the fund manager files shareholder resolutions and company AGMs demanding improvements in company behavior. While the impact of capital allocation declines dramatically as companies move from private to public markets, active ownership can be effective in delivering impact throughout the lifecycle of a company (assuming the shareholders are sufficiently influential to catalyze these improvements).
Capital allocation is also highly impactful in developing countries or regions where capital is scarce.
Impact through capital allocation

In order to demonstrate impact from capital allocation, an investment should be:

1. Directly financing the growth or development of a company or project resulting in enhanced sustainability and impact performance or outcomes (capital contribution).

2. Additional – the capital contributes to the total amount raised by a company or project, and is not easily substitutable (capital additionality).

These criteria are challenging; and for larger, commercial impact investors seeking market-rate deals, additionality may need to be interpreted generously, as it is difficult to establish whether a company would have been able to raise the capital from other investors on the same terms in the same timeframe.

Capital contribution
For capital allocation to be impactful it needs to fund directly a company’s growth, or finance an increase in quantity of impact, (e.g., an investment allows a company to expand its production of clean technology). Capital can also be impactful if it increases the quality of the impact, or upgrades a company, reducing negative impacts and/or increasing positive impacts.

The impact from capital allocation varies, depending on a company’s maturity and its risk. We also need to consider whether the capital directly finances corporate growth or represents shareholders simply exchanging ownership.

For example:

- Early-stage venture capital or growth private equity funds typically directly finance company growth. If it is an impactful business model, then company growth will result in impact growth. Capital is particularly additional if it provides an anchoring role, and gives confidence to other investors to follow.

- For investments in listed securities traded on secondary markets, there is no direct funding of underlying companies, as it involves simply buying securities from others in highly-liquid markets. Highly liquid secondary markets enable capital to be raised on primary markets, as they facilitate exits and liquidity, but it is difficult to demonstrate that buying shares in a company already trading on a highly liquid market has a measurable effect on impact generated by the company. This is why “impact investing”, strictly defined, typically does not include liquid strategies simply involving stock or bond selection.

- Private debt, such as project finance, can provide new sources of funding for developing new projects. It can also refinance existing projects, in which case capital contribution is limited and the link to additional impact severed. Therefore, investors need to assess the deployment of new capital into a company or project, and how much of this capital finances the growth of the impact activity.

- Bond issuances on primary markets require similar assessment in terms of split between refinancing and debt for additional growth or development. Bonds purchased on the secondary market are often purchased from other investors and therefore do not involve fresh capital for growth. A significant proportion of green bond issuance involves refinancing existing debt for established projects rather than financing new projects.

Indirect financing, refinancing and investing in securities in highly-liquid secondary markets is vital and allows the primary financiers of companies to exit and redeploy their capital into earlier stage companies or projects. However, to identify investments that most directly deliver impact, investors need to distinguish between investments that directly fund growth (impact investments), and those representing ownership exchanges or debt refinancing in sustainable companies or projects (sustainable investments). Both have an important role in a portfolio, but if investors want to drive impact directly, they need to appreciate and act on this distinction.
Capital additionality
The most challenging aspect of assessing investor contribution is the idea of additionality of capital: would the company have been financed on the same terms in the same timeframe without participation from the investor? How easily substitutable is the capital in light of other available alternative funding options?

It is difficult to establish what would have happened, but for the investment. Investors who focus on market-rate return investments will need to interpret this with some flexibility. If a company’s financial prospects are strong, and it can communicate this to a broad range of investors, the additionality of that one investor’s capital is difficult to establish, as other investors can fill the gap. If this is the case, whether the investor makes the investment or not, the end result for that company in terms of impact is the same.

However, there are many opportunities in the commercial and market-rate investment spectrum where fundraising is challenging, particularly in the smaller end of the private markets and in developing countries (and even disadvantaged areas in developed countries). Often businesses with potentially strong financial prospects will find it difficult to raise capital, particularly if few investors are aware of the opportunity, or understand how to assess risk and return. This is also true in times of economic downturn or uncertainty, where capital is scarce and investors are not investing. Indeed, for many earlier stage or developing country deals, it can take over 12 months to close a funding round.

It is also important to consider the total investment gap the investor is contributing to in a particular market, theme or region, and assess whether the capital is adding to the total. For example, developed country investors willing to invest in emerging or frontier market SMEs may be contributing additional capital to the country overall, given scarcity of capital, even if a particular deal would have been funded by other investors.

Similarly, at the fund level, it is unusual for first-time funds – whether impact-focused or not – to be oversubscribed. Impact investment funds often invest in underserved geographies or demographics, or in earlier-stage companies, where the number of investors with the capabilities or risk appetite to evaluate these opportunities is limited.

A simple heuristic for assessing the additionality of capital is the length of time an investee takes to close a funding round, or the difficulty in doing so. A long or challenging fund raise indicates that investors are contributing additional capital. However, a challenging fund raise may also be due to an unattractive investment from a financial perspective. But in most cases, there is a strong link between time taken to raise capital, and its “additionality” for a company.
At the other end of the spectrum, in more liquid markets, issuance or sale of a security is fully subscribed or executed within days – or sometimes minutes (for example, an AA-rated green bond issued by a blue chip corporation, or any stock trading on a liquid exchange). In these cases, it is difficult to argue that a company would not have secured capital otherwise and that participating in that issuance or purchasing that stock is bringing additional capital.

Indicators of capital additionality include:

- **Ease of access to funding:** Ease of access to capital is often a function of the maturity and life cycle of a company, the efficiency of the underlying market and the geography where the company operates. Larger companies in developed markets with broad access to investors and lenders typically have no problem accessing capital.

- **Size and maturity:** Start-ups generally find it difficult and time-consuming to secure finance, given the risks, limited history, lack of cash flows and often-untested business models. While expected returns can compensate for such risks, finding investors willing and able to commit capital into earlier stage illiquid investment opportunities takes time. Funding rounds from seed through Series A and Series B can take months or years, and the associated due diligence process is difficult and imprecise. Capital tends to be additional under these circumstances, though there are exceptions, for example, when early-stage funding rounds for particularly successful start-ups are oversubscribed.

- **Geography:** Companies in developing countries or disadvantaged regions within developed countries often have limited access to finance. Even if a company in such a region finds it easy to access capital, foreign investors are adding to the overall pot of capital going into that country, and that is likely to be additional.

- **Innovation:** Companies or investment vehicles focusing on new and innovative strategies may find few investors willing to take the time to understand and diligence these new technologies or strategies.

- **Flexible or unusual terms and structures:** Some impact investments seek to leverage innovative financing mechanisms, and include longer tenors, unusual blended finance structures that bring private and public capital together, evergreen holding companies (rather than typical LP/GP private equity structures), social impact bonds (taking risk on pay-for-performance contracts) and deals involving multilateral institutions as guarantors. Given the complexity involved in these vehicles – whether investing in the concessionary or market-rate tranches – this capital tends to be additional, as structures can sometimes take years to put together, and most investors would be unwilling to participate in these deals.

**Market efficiency – impact investing’s “elephant in the room”**

Market efficiency means that a security is priced based on all publicly available information. In efficient markets, there are unlimited buyers and sellers of the security; one investor buying or selling of the security will not affect the price (and therefore could not claim to have any impact).

While markets can be inefficient, the largest liquid markets, such as the New York Stock Exchange, are relatively efficient, compared to less developed markets such as early-stage African renewable energy companies.

How are market efficiency and impact investing related? The more efficient the market for a security, the smaller the impact an investment into that security is likely to have on cost of capital or the volume of capital available to the company for expansion. The only way to have impact through investing in a company is to provide growth capital that it would otherwise not have at similar terms and timeframe or help to lower the cost of capital. When a security or investment opportunity is efficiently priced, then by definition there are unlimited investors willing to invest at that same price.

Of course, if a large proportion of the market invests in, or divests from, a particular security, this could affect the cost of capital of underlying companies. However, these effects are very small, unless a large subset of investors embrace this trend. And if not supported by fundamentals, these effects are quickly arbitraged away by investors unconcerned with sustainability or impact.
Larger companies in developed markets with broad access to investors and lenders typically have no problem with accessing capital.
Investing with impact in early-stage Asian companies

We spoke to Joost Bilkes, Director, Head of APAC Region, Sustainability Strategy, Advisory & Finance (SSAF) Credit Suisse, about incorporating additionality into investing.

Q. The Asia Impact Investment Fund (AIIF) invests in early stage and growth stage Asian companies. What is the focus of your strategy?
We take minority stakes in high-growth, high impact small and medium-sized enterprises (SMEs) in South East Asia and China. We seek to build companies that improve the livelihoods of low-income communities in emerging markets, i.e., populations living at the base of the pyramid (BoP). In order to be eligible for investment from the Fund, a company’s business model must demonstrate that its commercial viability is predicated on addressing social and socio-environmental obstacles and challenges faced by the poor. More specifically, this means companies providing customers with goods and services that are affordable and accessible, and/or facilitating access to economic opportunities and markets for producers, suppliers or distributors. The Fund has a broad sectoral focus—healthcare, education, agriculture, access to finance, affordable housing—but every AIIF investment seeks to effect transformative change that builds sustainable livelihoods for Asia’s poor.

Q. How do you ensure you actually deliver impact?
Before investing, a rigorous impact assessment is undertaken on every opportunity. Indeed, from the moment a transaction is screened, eligibility is evaluated from the perspective of livelihood-improvement potential, impact depth and reach and the prospects for scalability and replicability. Once a transaction is in full due diligence, these aspects are interrogated more rigorously through onsite assessments, above all, we evaluate the means by which impact is generated; in other words, how realisation of the company’s strategy intrinsically drives impact generation. In some cases, impact can derive from organic growth, e.g., increasing the output and, reach of key goods and services; in others, it is the absorption of lower-income groups as economic actors into markets and value chains that generates impact. Once we have made an investment, we conduct regular field visits and undertake interviews with the members of the beneficiary groups to confirm our impact thesis and measure the impact throughout the investment period. We report more impact metrics in an annual Development Impact Report available to our investors.

Q. Additionality is a key element of impact investing. How would you describe your additionality?
Additionality is incorporated into the Fund thesis in three ways. First, AIIF capital is inherently additional, due to the dearth of risk capital available to SMEs in many parts of South-East Asia and China. Banks in the region remain very risk averse, and relatively few private-equity firms target initial investment ticket sizes of USD 4m - USD 8m. Early stage companies can often get concessionary or philanthropic capital, and larger companies can tap into international, commercial private equity capital flows, but the expertise, partnership and value addition that underpins engaged impact investment is what companies need most. We invest in a “sweet spot” where there are exciting opportunities, but where few other investors are looking. Out of 11 investments we’ve made, there were a couple that were through participation in Series A and B and the rest provided growth capital for more mature SMEs. These investments typically represent new money into impactful companies to grow them and deliver additional impact through that growth.
In many cases, the companies may not have found that capital elsewhere, or it would have taken them much longer to close a funding round.

The second area of additionality is in non-financial value addition. Depending on the growth stage and sophistication of an investee, the investment team supports companies in the following areas, among others: financial management and controls, balance sheet structure, inventory management and optimisation, management and governance more generally, strategic-decision making and pre-IPO preparation. Further, as part of the investment team, our team at Credit Suisse is also dedicated to working with companies to maximize the commercial impact-drivers. As with most private-equity investors, board representation is a *sine qua non* of investee engagement, but in the Fund’s view, it is the hand-holding and involvement in the undergrowth that adds true value.

Third, the imprimatur of investment from a Fund promoted by two major international financial institutions, UOB (through its venture management operation) and Credit Suisse, confers credibility and trust, which helps to catalyse additional investment from within and beyond the region. This has included major international foundations, pension funds and local commercial investors.
Impact through active ownership

Investors also contribute additional impact through being active owners, and – unlike direct financing of companies’ growth – this can be across asset classes and a company’s lifecycle, from seed-stage startups through to large-cap corporations. There are a variety of tools and approaches used by active owners to contribute to company impact.

**Direct engagement with management**

Fund managers can engage directly with investee companies on issues of concern or areas of improvement. They can speak to investee company management or join forces with other investors through engagement platforms such as the UN PRI Collaboration Platform.

Collaborative engagement platforms allow investors to share resources (such as research on target sectors, and information on which companies are leaders or laggards) and enhance their influence on companies with respect to ESG and impact performance. Most engagement dialogues are undertaken between equity fund managers and listed companies. However, bond managers are also beginning to engage with companies on ESG issues, primarily regarding downside risks that may be material to pricing of bonds.

**When assessing direct engagement capabilities of fund managers, investors should consider:**

- **Objectives and capabilities:** Does the fund manager clearly set out engagement objectives? Do they have the team and resources to undertake multi-year dialogues with companies? Shareholder engagement is a long-term undertaking, since most fund managers do not hold large stakes in companies. Building trust and influence with management teams is the basis of engagement, together with persuading a company that it is in its best interests to enhance its ESG or sustainability performance. Part of a fund manager’s capacity to deliver impact through engagement is due to their willingness to catalyze or collaborate with other investors.

- **Outcomes:** Fund managers claiming to engage with companies should be able to provide evidence and regular reporting regarding successful and unsuccessful engagements. Successful engagement with large cap companies is particularly challenging to attribute to a fund manager’s dialogue, as many other stakeholders may be pushing for the same outcome. However, if fund managers are spending considerable time and resources engaging with companies, they should be able to demonstrate that they are contributing, even as part of a coalition, to concrete outcomes.

Most ESG funds undertake engagement to some degree. However, the potential for delivering impact through engagement is typically not built into the investment process. Therefore, most ESG strategies are not considered impact investments, even if they are delivering some impact through engagement.

For true impact investment, the strategy needs to center on delivering impact through engagement, and the stock selection driven in part by the potential for improving companies and measuring that improvement. Most ESG funds are unable to demonstrate that delivering impact via engagement is not only part of their strategy, but also part of their stock selection process.

“Fund managers can engage directly with investee companies on issues of concern or areas of improvement.”
Engagement as an impact strategy

We spoke to Mia Overall, ESG Engagement Lead at Rockefeller Asset Management, about its active engagement strategies.

Q. How can investors generate impact through listed equities?
While it’s difficult to create impact through the investments themselves, as we are operating in secondary markets, it is certainly possible to use our influence as owners of companies to encourage, inspire and persuade companies to improve. We have a long and successful history in engaging with companies and have been able to influence even large corporates to change, by demonstrating that sustainability is where the world is heading, and it is in the best interests of the company to move in that direction.

Q. How can investors with a small shareholding encourage a company to change?
What we have found – and this is backed by the academic research – is that if you want to achieve sustained change in a company, management itself needs to be convinced. The most effective shareholder engagement is where we are able to demonstrate a strong business case for being more sustainable.

We are constructivists, not activists, and are a trusted advisor to companies, helping them find ways to be more sustainable and more profitable at the same time. There is plenty of low-hanging fruit. We want to outperform the market, and we need these companies to outperform their peers. Improving their sustainability performance and realizing an ESG quality premium in the market is the goal.

Q. You are a specialist in engaging with companies on ocean sustainability issues. What types of companies do you engage with and on what topics? How do you deliver SDG outcomes through engagement?
There are many opportunities to engage with companies around oceans. We’re encouraging retailers to reduce their plastic packaging and ensure they are sourcing seafood from sustainably managed and certified fisheries. We’re pushing the fishing companies to increase the proportion of their catch that is certified, whether from wild catch or aquaculture.

And there are strong business cases for many of these improvements. We typically select companies that are already aware of the issue, but need that additional push to drive momentum towards sustainability.
Impact through active ownership

Credit Suisse’s shareholder engagement on food waste
Reducing food loss and waste contributes directly to SDGs 2 (Zero Hunger), 12 (Responsible Consumption and Production), 13 (Climate Action) and potentially 15 (Life on Land – as we will need less land for agriculture if we can avoid food waste). Given that much food loss and waste occurs in the supply chains of listed companies, listed equity investors are well positioned to engage on this issue and make a difference.

We explored existing collaborative shareholder engagement activities undertaken on this topic (for example, via the UN PRI Collaboration Forum), to create additional impact through engaging with companies on the topic.

A key factor contributing to the success of shareholder engagement is a strong business case. When it comes to food loss and waste, we believe that there is a strong business case for many companies to step up efforts to reduce food waste. These differ between companies and include reducing costs and inputs, and enhancing customer relationships through demonstrating a company is avoiding waste.

Our strategy for engagement
We identify sectors/sub-industries such as retail/groceries, restaurant chains and hotels and assess the most effective steps companies can take to address this issue. We start the engagement with desktop research on companies and industry best practice, then send companies a questionnaire to get a better sense of what they are already doing on this issue. We engage in a dialogue with the companies to highlight the business case for addressing the issue, industry best practice and relevant partners or consultants that may be helpful for implementation. At the beginning of each engagement with a company, we set milestones for company change, and then monitor progress in achieving those milestones over a 12 to 24 month period. We also help companies establish KPIs for their performance on these issues and encourage them to report publicly their progress as part of their annual sustainability reporting cycle.

Credit Suisse is committed to creating as much positive impact as possible, while delivering superior returns to clients. We recognize that within listed markets, shareholder engagement is the key mechanism for impact, and look forward to building our engagement effectiveness over time.
Filing shareholder resolutions
When shareholder engagement fails to elicit an adequate response from the investee company, investors can choose to file shareholder proposals at company Annual General Meetings, to address issues and ask other shareholders to vote in favor. Shareholder proposals on sustainability issues are gaining increasing support, with a number achieving majority votes. According to CERES, an organization that coordinates institutional shareholder collaborations on sustainability issues, in 2019 around 39% of climate-related proposals were withdrawn ahead of AGMs after successful negotiations between shareholders and the company.3

Shareholder proposals do not need to achieve majority votes in order to be highly impactful and result in real change within companies. Typically, corporate management pays close attention to the concerns of a significant subset of shareholders, even if a proposal has support from only 10%-15% of shareholders.

Investors seeking to create impact within listed equities should expect their fund managers to be supportive of environmental and social shareholder proposals – and transparent about how they vote – as this can be an important tool for delivering impact within listed markets.

Climate Action 100+
The world needs to achieve carbon neutrality by 2050 if we are to limit global warming to 1.5 degrees Celsius. This objective was laid down in the Paris Agreement signed by 196 countries in the Paris agreement in 2015. Since then, shareholder engagement has focused on targeting emissions reductions from large corporate polluters.

Launched in December 2017, Climate Action 100+ is the largest investor-led collaborative shareholder engagement initiative, with 450 investor signatories representing USD40 trillion in assets.4 These investors are aiming to secure commitments from the world’s largest corporate greenhouse gas emitters to act on climate change. This shareholder engagement coalition focuses on 161 companies that account for around 80% of global emissions. The targeted companies operate in the oil and gas, mining and metals, transportation, industrials, electric utilities and consumer product sectors. Investors behind Climate Action 100+ engage with investee companies to drive changes including engagements on actions to curb emissions, strengthen climate-related financial disclosures and improve governance of climate change issues. They also file shareholder proposals asking for concrete climate strategies, including the linking of executive pay to emissions reductions.

While individual shareholders may have limited ability to elicit change from large companies, coalitions of institutional shareholders have the capacity to deliver significant impact through shareholder engagement, given the scale of the companies involved. A small reduction in emissions from a large, global corporation could represent a vastly larger impact compared with an earlier stage renewable energy company.

Examples of successful engagement strategies resulting in concrete action include BP agreeing to disclose how its capital expenditures, emission policies and broader strategy align with the Paris agreement after months of engagement with shareholders in early 2019. BP separately agreed to link the remuneration of 36,000 employees to greenhouse gas emission reduction targets.

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Impact through active ownership

Active ownership in private markets
Fund managers – particularly in private markets, where they often have larger shareholdings – can leverage their positions and influence to enhance the sustainability and ESG performance of investee companies.

- Participating on boards, and ensuring that sustainability and impact are core elements of the company strategy.
- Technical assistance, both on ESG and impact topics, as well as core business topics.
- Contributing to the strategy of the company, and helping the company develop over time.
- Supporting additional fundraising, and making introductions to potential investors.
- Providing introductions to potential strategic partners, for example, in new markets.
- For well-known investment institutions, leverage that brand to raise the profile of the investee company within the market.
- For PE firms with strategy and business-building capabilities, offering these capabilities to investee companies to ensure they grow faster.

For commercial private market fund managers doing deals in markets with many investors and abundant capital, their impact is derived primarily from the value-add they bring to the investee companies, rather than capital itself. It is therefore important for investors to recognize that investing in fund managers that add significant value to portfolio companies is an important criterion to assess when looking for impact.

We spoke to Andreas Wencke, Strategic Projects/ESG Solutions Credit Suisse, about investing with impact in real estate.

How do Credit Suisse’s property investments demonstrate additinality?
Credit Suisse invests in newly built properties and project developments in Switzerland that achieve high performance of energy efficiency and de-carbonization compared with peers. In addition to the financial contribution in raising capital and institutionalizing investments in green real estate, we are an active owner that contributes through non-financial means to the decarbonization of the real estate sector. We developed the greenproperty quality seal; the first comprehensive standard for sustainable property in Switzerland, including 50 environmental, social and governance indicators including carbon emission. We have also established a partnership with Siemens on an environmental management system to measure, optimize and report on the environmental performance at the asset level.

The optimization measures cover energy and heating systems with performance objectives for both energy efficiency and carbon reduction. Our strategy has successfully delivered significantly above average environmental performance of the portfolio assets. In 2018, the strategy achieved energy consumption of 92 kWh/m², against the national average of some 125 kWh – a decline of 7 percent since 2012. Similarly, CO2 emissions fell to 13.6 kg CO2/m², which is 60 percent below the national average of 33 kg CO2/m² – a decline of nine percent since 2012. We believe this would not have happened but for our proactive commitment to financing buildings that are greener than average, and working with our partners to continue to reduce emissions.

Exploring impact series: The Double Delta of impact investing – Credit Suisse
Quadria is one of Asia’s largest private equity healthcare investors with over USD2 billion of assets under management and over 20 investments across South and Southeast Asia. It invests in high growth companies that provide affordable healthcare services and products to millions of patients. Quadria’s investments directly benefit underprivileged populations that otherwise lack access to essential healthcare. The intention to create impact at scale through providing high-quality, low-cost healthcare is at the core of Quadria’s services, and guides how the organization invests and engages with investees. Quadria measures this impact using a set of impact metrics established at its foundation, reported quarterly and audited annually.

Q. How do you provide capital to companies that would otherwise be unavailable?
As one of the region’s leading strategic healthcare investors, we collaborate with high-quality, leading healthcare businesses through proprietary relationships built over several years. Many have strong, stable cash flows and are not short of suitors. These domestic and regional businesses are typically family-owned, well-funded and rarely in need of capital. Further, they are often skeptical of private equity and if in need of capital, have the option of multiple funding sources. As such, to be successful in sourcing the best-positioned companies, we have to bring a lot more to the table beyond financial capital.

Q. How about proprietary deals? Do you originate deals or projects?
The significant majority of our deals are proprietary; Quadria has pursued these transactions outside typical auction processes. We need to demonstrate to the owners the value we bring. This is the primary reason healthcare entrepreneurs and families choose to work with us. The only reason they will open the door to PE is if it can bring tangible value that supports growth whether it is revenue growth, building scale, margin improvement and/or strategic initiatives.

An example is Soho Global Health, one of Indonesia’s largest and fastest growing pharmaceutical businesses that owns the No 1 selling pharma brand in the country. When we approached Soho Global Health, its owner told us to “join the queue”. Many others had approached the family given its quality and market-position. We had to demonstrate that we could bring something different that would drive transformational growth to the business and would be difficult for Soho Global Health to execute on their own.

Even before we made the investment, we spent months working on a business plan that clearly outlined the role of Quadria and our value-add. For example, Quadria supported its business development capability with a focus on drug in-licensing and we had identified 15 highly differentiated drugs that were either limited or unavailable in Indonesia. We then developed the pathway from securing those drugs to launch, sales and marketing. We are pleased that Soho has now in-licensed over 36 products, many of which are critical life-saving drugs, now offered at affordable prices through both private and government channels. This created significant financial uplift for the company as well as social impact.
Q. What about your Indian hospital deals? What was your value-add here?
We invested in the world's largest gastric sciences hospital, the Asian Institute of Gastroenterology (AIG), and took it from a 300-bed hospital to over 1,000 beds. This generated significant economies of scale, passed on to patients in the form of high quality, affordable healthcare. In addition to building scale, we worked closely with AIG's management and clinical team to secure a partnership with the Mayo Clinic, the first-of-its-kind outside the US, allowing AIG access to the Mayo Clinic Network and its clinical resources to scale up AIG's clinical expertise.

Despite posting globally best-in-class profit margins, AIG charges a low USD17 per endoscopic procedure compared to USD2,500 and USD1,600 in the US and Europe, respectively. For a colonoscopy, AIG charges USD24 per procedure compared to USD3,600 and USD1,800 in the US and Europe, respectively.

Q. How has support from Credit Suisse added value to your fund and the enhanced the impact it can make?
In our recent fund raise, we were oversubscribed and hit our hard cap of USD600m – far exceeding our initial target of USD400m – due in large part to the additional capital from Credit Suisse clients. The Credit Suisse platform gave us access to numerous family groups in Asia and globally with healthcare and related businesses on the ground that we can leverage for further value creation at our portfolio companies. Credit Suisse also allowed us to diversify our investor base, and bring in a number of LPs who can become strategic investors in these businesses, which can help our companies even grow faster and deliver even more impact.
How do we measure and report on the impact of investors?

Fund managers should monitor and report on the impact of their capital allocation and active ownership contributions — not just the impact of the underlying investee companies. This is not easy, and to date, very few fund managers are doing this well. Reporting on investor contribution involves assessing the additional impact the investment generated beyond what would have happened without that investment. The improvement in various sustainability or impact metrics, or growth in an impactful company’s business, may be the result of many different factors, and it can be difficult to unpick the combination or proportion attributable to investors or an investment. In the absence of well-defined standards and roadmaps to measure such investor impact, fund managers need to have:

1. A clear articulation of the theory of change; and
2. Transparency regarding the execution of their strategy, so they are accountable for the impact claims being made.

Until more robust evaluation methodologies around investor contribution and additionality are developed, quantification will be difficult. Most fund managers will lay out their theory of change; their explanation of how exactly their investment or active ownership activities are generating impact; and evidence that the underlying companies or projects are delivering expected impact in line with the theory of change.

While it can be challenging to evaluate and then report on the contribution of the capital allocation and active ownership by a fund manager or investor, failing to do so leaves investors in the dark regarding their likely achievement of impact. People often measure what is easy to measure, and gravitate towards verifiable metrics. Within impact investing, these metrics typically sit at the company level, and reflect facts about the environmental and social management of companies, or impacts of products and services — leaving the investor level without discussion.

Investors should evaluate as best they can the contribution that fund managers are making, or likely to make, based on the concepts discussed in this paper. While these are not strict criteria for investment, they can be helpful for developing rough indicators of the likely future impact of an investment compared with other opportunities.

In the absence of more developed and universal agreement on metrics and reporting by investors and fund managers, it is key that those providing and receiving capital up and down the chain are transparent. We may measure things differently, but all the industry participants should be open about what they are doing or not doing in generating outcomes that help solve humanity’s challenges.

“Fund managers should monitor and report on the impact of their capital allocation and active ownership contributions.”
Conclusion

We have focused on how investors can maximize the likelihood of delivering positive impact through their investments in a field that is still in its infancy, and with very few quantitative tools at their disposal.

The industry is moving along quickly to address these challenges. The IFC Operating Principles for Impact Management play an important role in setting out how investors and fund managers can maximize impact. Principle 3 is key and worth reiterating:

The [fund] Manager shall seek to establish and document a credible narrative on its contribution to the achievement of impact for each investment. Contributions can be made through one or more financial and/or non-financial channels. The narrative should be stated in clear terms and supported, as much as possible, by evidence.

This Principle sits at the heart of impact investing, and without a contribution to the impact of underlying enterprises, we simply have no impact. At Credit Suisse, we are committed to offering our clients a variety of sustainable investing strategies that fulfil different roles in portfolios. This includes impact investments that can demonstrate real additionality and allow our clients to move the needle – in measurable ways – on important issues and themes.

We recognize that our clients seek investments that deliver commercial, market-rate returns. We believe that impact investing can do both: deliver real, additional impact and commercial returns. Indeed, unless we deliver returns as attractive as traditional investments, these investments are unlikely to scale and deliver the impact we need to meet humanity’s challenges.

We look forward to the ongoing development of this industry, and more robust analyses of the achievement of impact by investors, while we continue to deliver high-impact and commercially-attractive strategies to our clients.

For more information about Credit Suisse’s commitment to the Operating Principles and our strategy to create impact, please find our Disclosure Statement here: https://www.credit-suisse.com/about-us/en/our-company/corporate-responsibility/banking/agreements-memberships.html
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