Impact investing

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WHY THE GAME NEEDS TO CHANGE

Pervasive short-termism … has hampered the capacity to compete on a sustained basis in international markets; diverted human and financial resources from needed investments in innovation; dispirited employees and managers, leading to pervasive disengagement; generated 'bad profits' that undermined customer loyalty; caused excessive 'financialization' of the economy, making it vulnerable to increasingly severe financial crashes; undermined the economic recovery from the Global Financial Crisis; drastically reduced rates of return on assets and on invested capital; appropriated gains that flowed from workers' improvements in productivity; and led to secular economic stagnation and increasingly unsustainable economic inequality.[1]

This chilling assessment from recent research by NYU Stern and Harvard Business School lists the disastrous consequence of pursuing shareholder value. It is no less emblematic of the South African asset management industry, where transformation has remained stubbornly intractable for the past 25 years. We've heard the arguments before. In South Africa, the five largest asset managers have approximately 50% of all assets available for private-sector management – around R4.6 trillion in 2017 out of a total South African savings pool of R7.9 trillion.[2] While the number of black-owned asset management firms has grown significantly (now standing at around 45 firms),[3] their slice of this very large pie has remained low, at between 4% and 9%, depending on the form of calculation.[4] The ninth annual BEE.conomics™ Survey, for example, calculates the value of assets to be R415.5 billion (or 9%) in 2017.

To date, efforts to kick-start the transformation of the industry have taken three basic approaches. The first has been to redistribute a portion of the assets managed by the Public Investment Corporation (PIC) and other state-owned enterprises. The second approach is really a variation of the first: use incubation funds to bring emerging managers into a multi-managed solution, give them a strict mandate and watch them closely until they are on a firm footing. The third is a sort of incubation platform that provides administrative, technological and business support to emerging asset managers. The theory here is that reducing their basic costs and management distractions enables them to get on with what they theoretically do best: manage assets.

However, none of these models really gets to the heart of the problem. Let's take the elaborate exercise the PIC undertook about 10 years ago when it wanted to redistribute its external investment mandates to a wider, more transformed array of newer asset managers. There were more than 70 submissions in that tender process. B-BBEE credentials were a critical feature. Disappointingly, though, many submissions simply rehashed the winning strategy of the asset management industry at that time: value investing. In fact, many included marketing materials that looked and sounded just like an Allan Gray fund.

Why was this a particular issue? For any large fund such as the PIC – or the Eskom or Transnet pension funds for that matter – redistributing assets to managers with the same investment strategies is like asking a group of fishermen to fish from small fishing hole in a big pond. In investment terms, any value-add that may have been gained from each manager's stock-selection skills would simply get diversified away into what would in effect be one big value bet – something that could be easily replicated, at a far lower cost, with a factor index strategy.

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DETERMINING MARKET AND COMMON-FACTOR RISK

Lesson

The more we understand how performance drivers change as we move from owning a single share to an investment in a portfolio of shares, to an investment in an array of manager portfolios, the easier it is to understand why large-scale multiple manager solutions can be problematic.

As Figure 2.4.1 illustrates, we can usually break down the performance of a single share into elements of:

- specific risk: characteristics unique to the company
- common-factor risk: characteristics the company shares with other companies
- market risk: the fact that the market itself is going up or down

When you combine shares into one portfolio to diversify performance risk, market risk and, to a lesser extent, common-factor risk will tend to dominate, with individual share attributes (specific risk) becoming a significantly less important driver of return – in this case only 2%.

This effect is magnified even further when you combine different portfolios of different managers. Almost 98% of the performance in an aggregate portfolio is explained by whether the market went up or down. If a fund uses multiple managers with similar investment philosophies, the performance drivers are reduced to market performance primarily, and whether that particular investment style went up or down. Almost no returns can be attributed to the manager's stock-selection skills because their contribution has been diversified away.

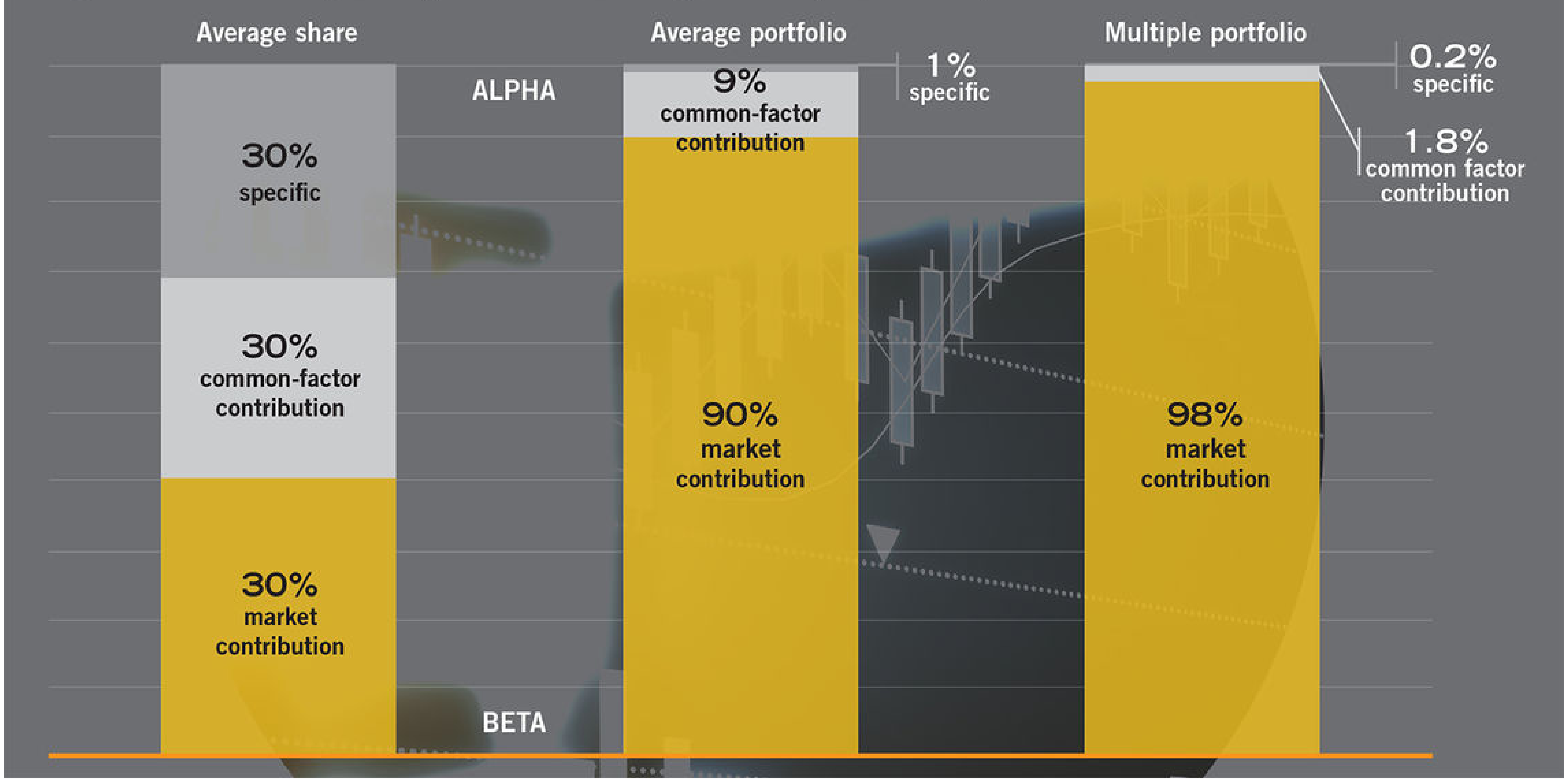
The point is, both market and common-factor performance could be captured by index funds at significantly lower cost than an active manager would typically charge.

Jargon buster
A factor index captures characteristics that are common to a specific group of companies and might explain their performance in the market. For example:

- **size**: small companies will tend to perform differently from large companies
- **rand hedge**: performance may be similar because companies' outputs are not affected by rand volatility
- **value**: companies may be in different industries but they are all trading at a price that is much lower than their assessed value

Factor-driven performance contrasts with 'share-specific' performance, which is where the specific characteristics of an individual company are the dominant driver of its performance.

Figure 2.4.1: What really drives performance? Building blocks of portfolio theory



Source: Barr Rosenberg^5

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Bottom line: as with other industries, it's hard to get traction as the new kid on the block unless you can break though the barricade of oligopolistic behaviour in the industry. As we said earlier, asset management in South Africa is concentrated in a very select group of hands.

What 'breaking the barrier' actually requires is a differentiated value proposition in terms of either an investment strategy or an investment solution. Demonstrate that you can start tackling problems where South Africa has a burning funding need, and people may well sit up and take notice.

But the problem before us isn't strictly the composition and share of assets under management. It is the lack of differentiation in value that comes from active investing that is at the heart of the problem. What if we helped these emerging asset managers tackle their differentiated value problem from a completely different perspective? It could well be that the time is ripe for such an approach to gain traction in the asset management industry in general, and developing economies in particular.

Before turning to the solution, let's explore the problem at hand.

Confronting the problem, creating a differentiated value proposition

While South Africa has a fairly sophisticated asset management industry – first-world by active-manager standards – what it doesn't have is a new pond (to continue with our metaphor) that recontours the industry boundaries and refashions the application of investment strategies to provide for the country's and society's specific funding needs, addressing head-on the growth, job creation and impact that South Africa needs at this point in time. Fortunately, there is already an awakening of sorts in the industry globally. As the Future of Finance arm of the CFA Institute has been emphatically arguing, unless asset managers wake up to the radical changes taking place in the world around them, their livelihoods, to say nothing of the livelihoods of new entrants, will be at stake:

In return for living up to society's expectations, investment institutions receive from society a license to operate – a tacit approval to exist and function. But it can be revoked, and investment organizations need to start rethinking a new model of professionalism that brings benefits to both society and the industry if they want to retain that license.[6]

Investing for impact – where investing directly has the potential to provide significantly greater multiplier effect for society – could well be the model that gets that licence reissued.

Jargon buster
Multiplier effect: The ability of an investment to stimulate broader economic and social benefits in a country. (In the previous article, we pointed out that, managed effectively, direct investing into long-term care could have a multiplier effect of as much as 1.5 times over three years.)

How, then, do we transform the next generation of asset managers so that this could be a viable proposition – not just another differentiated investment strategy or asset class but a strategy that could add significantly more value to the South African economy than our current investment models?

Let's start by asking some serious questions about our current assumptions and models for savings. Then, little by little, we can build the case for why impact investing addresses so many concerns investors have about the future of finance.

1. Start by challenging our assumptions about what happens when we channel savings into the stock market

For decades we've taken it for granted that the asset management industry performs a critical function in retirement savings. By theoretically growing those savings at a greater rate than inflation, it allows fund members to draw a viable income long after they have left employment. We've also accepted the proposition that saving through the listed financial markets stimulates economic growth: when profits go up, companies use the cash as a foundation for future profits. This in turn should create jobs, generate more capital goods and lead to higher wages. That's how we've been told high-growth economies work. It's only natural that we think of our hard-earned savings as a catalyst for more job opportunities – something that South Africa desperately needs.

It's time we start questioning those assumptions. What if it turned out that investing in the stock market did not provide the kind of job stimulus that South Africa requires, and there might be other forms of direct investing with a significantly greater multiplier effect?

This is a question that clearly warrants further investigation – and it's on our research agenda. Right now, the evidence is convincing enough. It suggests that newly formed small enterprises are net value and job creators. Consider some of the research on listed companies that is coming out of North America from the Ewing Marion Kauffman Foundation and the Institute for Competitiveness & Prosperity. Over the last 25 years in the US, almost all private-sector jobs have been created by businesses less than five years old. In fact, between 1988 and 2011, companies more than five years old destroyed more jobs than they created in all but eight of those years, presumably because of the maturity curve which classically sees start-ups shedding value before either growing or failing. What makes this point particularly interesting is that, in the US at least, it wasn't small businesses in general that created jobs, but new businesses. As the authors point out, these 'new firms also contribute to economic dynamism by injecting competition into markets and spurring innovation'.[7]

Research from NYU Stern and Harvard Business School points to an even more disturbing phenomenon: apparently, this 'reluctance to invest in the future' seems to be far more prevalent in listed companies, suggesting they may not be the real engine room for growing the economy.[8]

The question those authors ask is: 'Where is all the money going?' If share prices are going up, why are these companies not using those increases to create jobs? For the US, it appears that the bulk of those funds for listed companies are being used for stock buy-backs, an effective mechanism for boosting share prices but not necessarily the best mechanism for enhancing economic prosperity. Who would want to do that? The research suggests it's the very executives whose remuneration is based on meeting short-term earnings targets and share price increases.[9] Little wonder that, under those incentives, under-investment becomes the order of the day.

Needless to say, these assessments are not definitive. There is still substantial debate as to whether we have explored all the proper metrics for drawing these conclusions. But the debates that have arisen provide some powerful pointers for how to structure a research agenda for South Africa that moves us closer to a new investment model. Specifically, there are four broad, distinctly different areas for consideration:

- the extent to which revenue is derived from South Africa-based production or services
- the extent of share buy-backs on the JSE, net shareholder payouts and the R&D-adjusted net income of companies
- the nature of the redistribution of cash from black economic empowerment (BEE) programmes to broad-based shareholders – how effective are these programmes, actually?
- the extent to which listed entities may be investing their cash piles into enterprise and supply chain development and transformation, thereby creating economic value elsewhere

While we may not have the full picture just yet, we certainly have good reason to pause for thought. We believe the time has come to re-examine our widely held assumptions about how best to deploy long-term savings to promote multiplier growth and job creation.So, where does this discussion take us?

2. Ask where South Africa needs to change its investment focus

Much is being written globally about the need for industry change and innovation. For a host of reasons, the value added by professional managers has been low, or even negative, after fees. The traditional alpha-generation asset management business model is under threat as asset flows shift to cheaper alternatives like index, passive and smart-beta funds, and as clients and advisers take a more 'solutionist' mindset and seek better value for money.

Jargon buster
Alpha-generation asset management refers to the way active asset managers are assessed on their ability to provide risk-adjusted returns above a defined benchmark. As active alpha-generating asset managers typically demand higher fees, a question arises as to whether these higher fees are still warranted if the amount of alpha being generated is declining.

Indeed, Larry Swedroe's latest study on the battle between active and passive strategies suggests that, at least in the US, the longer the time horizon, the greater the failure rate of active funds against their benchmarks, and that's even before considering taxes.[10] Fama and French's research on the same markets found that alpha generation has come down, from 20% of active fund managers outperforming their benchmarks 20 years ago to only 2% doing so in 2018. This was the problem that we illustrated in Figure 2.4.1 on page 195 on what really drives performance. They also note that because passive smart-beta strategies, such as small-cap and value strategies, are outperforming traditional passive full-market strategies, the game has now moved on to these sorts of variations in investing.[11]

Much of this assessment applies equally to the South African asset management industry, although investors in South Africa don't appear to be quite so ready to move on from their status as active-manager market leaders. This may well be because the South African market has simply been so successful for so long (until the beginning of 2017, it was the top-performing global equity market over a 116-year period).[12] Active investing has remained relatively unchallenged as the preferred route to wealth creation.

It seems highly unlikely that South Africa will remain isolated from the current shifts that are materialising globally. While our industry is well developed in a global context and our financial markets are globally sophisticated, our country has unique challenges that the industry has left unattended.

We have a dual economy with huge disparities in income and employment, inadequate education and skills development, and a massive need for infrastructure development. Infrastructure investment doesn't just refer to energy sources or transportation, it also includes societal needs such as affordable housing, schools and care facilities, and other investments which help to improve the lives of citizens, and facilitate economic and social progress. At the same time, we have a transformation imperative, the pace of which needs to accelerate – but not in isolation from the other challenges listed above. That means we need to consider alternative models of asset management which can go at least some way to addressing the funding needs of our country while providing a new and differentiated value proposition that can be offered by a new generation of asset manager.

The bottom line here is that as investors become more focused on getting both value for money from their asset class exposures as well as value for the economy from their funding decisions, we are likely to see a dramatic shift in investment allocations. Passive beta strategies will attract that part of long-term investing that needs to capture the inflation-beating returns and liquidity embedded in the different listed asset classes, and active investing will shift its focus to the higher multiplier potential of impact investing.

3. Why next-generation asset management needs to transform professionalism in the industry

The creation of a next-generation asset management capability throws the spotlight on the concepts of professionalism and fiduciary responsibility to the industry.

One of the debates put forward by the CFA Institute is whether the industry is attracting the right type of professional. The fundamental problem is that investing is attractive because of the high level of instant gratification that occurs when one gets it right. The challenge comes when one tries to assess whether an investment 'win' was a function of skill or luck.

Consider this wonderful example that Morgan Housel, of the Collaborative Fund, relates in his tale of two investors.[13] One, Grace Groner, a secretary with a meagre salary and modest living requirements, manages to accumulate an astonishing $7 000 000 by the time she dies, at the age of 100, through the regular compounding of savings from her secretarial salary over 80 years. The other, Richard Fuscone, a former vice chair of Merrill Lynch's Latin America division, ends up declaring personal bankruptcy after overspending on his personal property ventures.

The point of this story is not to pass judgement on either investor. Rather, it is to provide this interesting observation by Morgan Housel:

In what other field does someone with no education, no relevant experience, no resources, and no connections vastly outperform someone with the best education, the most relevant experiences, the best resources and the best connections? There will never be a story of a Grace Groner performing heart surgery better than a Harvard-trained cardiologist. Or building a faster chip than Apple's engineers. Unthinkable.[14]

When we try to help young investment professionals understand how little control they have over 'Mr Market' and their ability to translate investment and valuation acumen into investment performance, the problem we ought to be addressing comes into sharper focus as we grapple with our development imperatives. And this is where we need to focus the attention of our next generation of asset managers if we want both client- and country-focused investment initiatives to add value.

Jargon buster
'Mr Market' is an allegorical figure used by Benjamin Graham in his seminal work The Intelligent Investor. Because this figure is actually the aggregation of all the psychological biases of the stock market's participants, Graham suggests that Mr Market lends a constant measure of unpredictability and irrationality to the market's movements.[15]

Shifting the paradigm: investing for impact

Whether an investment opportunity exists in a listed vehicle or as a direct investment, the principles for determining its business potential, the sustainability of that potential, and the present and future value of that potential remain very much the same. The primary differences between direct impact investing and investing through the markets are as follows:

- With **listed investments**, the asset manager needs to consider how the other players in the market are likely to view or value that investment opportunity. So, the real game played by the active manager is whether holding a different view from those other market participants is likely to pay off.
  For example: In the immediate wake of the Marikana tragedy, investors saw nothing but problems ahead for Lonmin. The share looked like an obvious sell. When too many investors believe the same thing, another market participant, the contrarian manager, will sweep in and snap up the heavily discounted share, causing the share to counter-intuitively spike upwards over the short term. Getting your sell timing right here is particularly tricky.

- With **impact investing,** the valuation assessment is compounded by also having to take account of the multiplier value of the investment on societal issues such as targeted job creation, skills development, education, housing, innovation acceleration, improvements in healthcare, resource management, environmental impact and so forth.

  Again, the time frame is important. How many years will it take for those direct investments to produce the societal benefits desired?

  The answer here is: Much longer than most investors are typically used to – even when they purport to be investing for long-term savings. But we will return to this discussion of a viable liquid investment vehicle a bit later in the discussion.

What we are trying to emphasise here is that shifting the investment professional's focus to this variation on investing is not an untenable proposition. More importantly, the attractiveness of impact investing is that it provides a better match and application of skills for investment professionals whose primary focus is on valuations. By contrast, active investing in listed markets introduces additional, random variables to the equation that make the transfer of that skill highly problematic.

Traditional active-manager mandates may still have some time to run in South Africa. Indeed, newly formed boutique firms that can demonstrate a better grasp of emerging investment opportunities more relevant to South Africa's future may be able to add significantly differentiated value here. This means that emerging active managers may still be able to offer a differentiated value proposition. What we are increasingly understanding about asset management performance, though, is that no matter how good the stock-selection skills of active managers might be, there are simply too many constraints and market elements that are out of their control for them to translate those skills into performance outcomes with any certainty. This is the bitter pill that active managers globally are learning to swallow. It's the insight that is leading a large segment of the professionals in that industry to rethink their value proposition.

In the past, many newly formed businesses, including black-owned and -managed businesses, were created by copying existing successful models. While this strategy might work for a handful of managers who just happen to be in the right place at the right time, South Africa needs investment businesses that are prepared to challenge the status quo, to forge new paths and disrupt existing models. Neither new asset managers with a traditional approach nor hedge fund managers will make the grade.

What we need are new businesses that have a more purposeful mandate, such as deploying capital to high-impact investments which generate good, sustainable returns and have higher societal multipliers.

How to create a more receptive environment for impact investing in South Africa

The Global Impact Investing Network (GIIN) reports that, with assets under management for impact investing now growing by 15% to 18%, compounded annually, socially responsible investing strategies have far outpaced the growth of traditionally managed active assets. That said, South African investors are lagging in this trend, in spite of the South African market being identified as a particularly attractive growth prospect.[16]

But here is the crux of the problem: as a value proposition, investing can either be seen as (in University of Pretoria economist Lorenzo Fioramonti's words) the 'blind pursuit of something called "economic growth"[17] or the pursuit of sustainable and inclusive development. The distinction is well made: if we only think of impact investing as yet another new asset class that can offer diversification benefits alongside social returns, then impact investing will compete alongside other alternative asset classes such as hedge funds, direct property and private equity in the limited space made available by collective investment regulations. At this point, that's a mere 10% of total assets if these investments are unlisted – although potentially more if they can be embedded in listed vehicles. This means that we will see only incremental increases in interest from potential sources of funding, such as pension funds and other savings vehicles, despite that the value proposition for impact investing being decidedly different from these other investments.

From our multiplier lens, impact investing has the potential to be so much more than any of those options. That is the investment narrative in South Africa that needs to change if we are going to convince asset owners, asset consultants and regulators that there is a far more important value proposition here than the blind pursuit of growth. Embracing impact investing provides us with just such an opportunity to completely reshape the way the asset management ecosystem behaves – and therein lies its appeal and power.

Perhaps the vision set out in GIIN's 2017 Annual Review makes the case best. We will quote it in full below:

This vision paints, by design, an aspirational future for financial markets, one towards which we all must drive. Anything less would simply be unsustainable. And while this vision will take time to be fully realized, the decisions we make today and tomorrow are critically important, as what we set in place now will ripple into the future. We must focus our collective sense of urgency to have an impact on all investing.

It will be 'normal' to factor social and environmental impact into all types of investment decisions. Indeed, the value propositions of all types of investing that integrate impact will enjoy wide acceptance, with plentiful evidence in their favour. Businesses and investors will be accountable to multiple sets of stakeholders, including shareholders, employees, customers, suppliers, affected communities, and local and global environments. With 'do no harm' the baseline standard for investing, investors will also allocate substantial capital toward investments that have social and environmental goals at the forefront. Impact investments will be a viable, taken-for-granted option for every investor, from retail to institutional.

Executing impact investment strategies will be facilitated by greater transparency, with comprehensible, accessible, and sophisticated standards for measuring and understanding impact. Benchmarks will aggregate performance across impact and financial indicators. Financial firms will tie incentives to achieved social and environmental impact. The concept of 'externalities' will be relegated to history, with finance theory accounting equally well for risk, return, and impact. Rewards for unsustainable, short-term profits will recede. Analysts and decision-makers will prioritize long-term performance (both impact and financial), while also addressing urgent, near-term challenges — a requisite ingredient for long-term sustainability. As a result, a greater share of capital will be invested in the real economy; the global financial system will thereby enjoy greater stability, with major crashes fewer and farther between.

Noticeable shifts in access and power dynamics will derive both from increased representation of women and other historically underrepresented groups in high-level positions and from the consideration of broader groups of stakeholders and affected parties beyond the shareholder. The voices of investees, beneficiaries, and other affected parties will be heard more clearly and included more systematically. Furthermore, billions who were previously excluded will gain access to capital markets, enabled by new products and distribution mechanisms.[18]

But first – there's work to be done

Changing the narrative around impact investing first demands that we need to do more to make this a more formally constituted investment option. This means we need better organising principles for how impact investing is managed on behalf of investors. For listed assets, the various different exchanges (such as the JSE) perform such a function. There would need to be a similar functionary in this space.

The problem that we currently face is that, as with many new investment concepts, formalising the thinking is typically driven first by the private sector, before inching its way forward through industry bodies, and finally it hitting the regulators and policymakers only when there are perceptions that there needs to be greater transparency and clarity if investor interests are to be properly protected.

This is indeed what appears to be happening with impact investing. Because the term can cover a multitude of concepts, asset class segments and investment vehicles, there are any number of smaller groupings that are operating in their own separate spaces at this point. But therein lies the problem.

Towards a framework for impact investing

A formalised framework for impact investing, with agreed definitions of key concepts and outcomes, will help to align the understanding and activities of all players in the ecosystem. Our starting point, then is to understand exactly what the ecosystem for impact investing looks like. To this end the South African Social Impact Investing Advisory Board provide a useful way of conceptualising this ecosystem. Table 2.4.1 maps their vision.

Table 2.4.1: Mapping the impact investment ecosystem

Impact sector	Impact purchaser	Impact-driven organisations	Forms of finance	Channels of capital	Sources of impact capital
Affordable housing, health, employment, education, criminal justice, access to finance, financial inclusion, environment, energy, agriculture and skills development	Government Foundations Socially minded consumers Socially minded corporate purchasers	Grant-reliant non-profit organisations Grant-funded non-profit organisations with revenue-generating activities Social enterprises Profit-with-purpose businesses Cooperatives For-profit businesses	Secured loans Unsecured loans Non-traditional debt and equity structures Equity Grants	Financial institutions Impact investment funds Crowdfunding platforms Impact investment intermediaries Enterprise and supplier development funds	Government and development finance institutions Foundations Financial institutions Pension funds Corporations High-net-worth individual

Source: South African Social Impact Investing National Advisory Board

If we are to create the right focus and impetus, the thinking of this ecosystem needs to be aligned with a set of credible, mutually agreed principles that define and clarify:

- what it means to be an impact investor
- the best practices for impact measurement, management and reporting
- the roles of various types of capital by recognising their risk-and-return expectations and understanding their importance in the capital spectrum as reflected in Figure 2.4.2.

In countries like the UK, France and the Netherlands, government has called upon industry to provide the guidance as to what this would need to look like. For example, in the UK, Prime Minister Theresa May set up an independent advisory group, headed by the vice chair of Allianz Group Investors, Elizabeth Corley, to suggest how impact investing could be made more transparent and accessible to UK investors. The goal is to accelerate the development of social impact investing opportunities and, over time, devise ways to ensure that impact considerations become an integral part of all investment decisions.

The group produced its report in 2017 with the following recommendations for promoting greater acceptance of this approach:[19]

- Improve deal flow and the ability to invest at scale.
- Strengthen competence and confidence within the financial services industry.
- Develop better reporting of non-financial outcomes.
- Make it easier for people to invest.
- Maintain momentum and build cohesion across initiatives.[20]

In March 2018 an industry taskforce was commissioned to progress the recommendations in the report. This commission has now evolved into a body with increasingly global reach.

Other entities, such as the Global Impact Investment Network, have also played an important role in 'mainstreaming' the concept of impact investing. They take the discussion of what needs to happen next just a few steps further and suggest six targeted areas as a framework for action. These are set out in Figure 2.4.2.

Figure 2.4.2: Impact investing: framework for action

Source: Global Impact Investing Network

An important question for South Africa is whether it needs a similar initiative of its own, or whether it should build on the experiences of global bodies such as the UK initiative or the Global Impact Investment Network. Indeed, South Africa currently has its own South African Social Impact Investing National Advisory Board. Its secretariat functions are coordinated by The Bertha Centre for Social Innovation and Entrepreneurship at the Graduate School of Business at the University of Cape Town. The role of the National Advisory Board will be to 'identify areas of focus and advocate for a series of public and private sector strategies in order to support the growth of the market'. As their website explains:

South Africa will be the first African country to take part in the Global Social Impact Investing Steering Group (GSGII), which was established in 2015 as the successor to the Social Impact Investment Taskforce, established by G8. The GSGII is continuing the work of the Taskforce in catalysing a global social impact investment market across a wider membership.

The GSGII is promoting a unified view of impact investment, facilitating knowledge exchange and encouraging policy change in national markets. Led by Sir Ronald Cohen, it brings together leaders from the worlds of finance, business and philanthropy across the globe, as well as government officials and network organisations active in supporting the impact investment sector.

Our own view is that these hybrid strategies that allow South Africa to participate in framing best global practice while also reflecting that South Africa has some of its own unique challenges would be optimal. No doubt lessons learned, for these local challenges could be equally valuable to other markets around the world.

How to move forward

Impact investing needs to hold a special place in the future of finance for South Africa. That demands that we solve for issues that might represent specific barriers to acceptance in the South African investment community. These issues span the full value chain: from how we think about investing, to how we structure the optimal vehicles for our specific investment needs to, and how we get buy-in from the gatekeepers. The list below highlights three such issues – and we recognise that there may be many more. But let's get started.

- South Africa will need to revamp the way asset management is taught both at university and the various continuing levels of professional development. This revamped curriculum would focus more on helping students understand what drives performance and how little transfer of skill actually takes place in the final outcome. It will encourage more critical thinking about project valuations to address issues of impact and consider the multiplier effect. Finance theory will need to be reframed in such a way that risk, return and impact are all considered in equal measure, with financial markets recast as being central to supporting solutions to critical threats facing the world.

  Get this right and we could integrate our curricula concepts with those of global chartered financial analyst programmes.

- To capture the full multiplier impact, timeframe will be a critical factor. A private equity model that depends on exit strategies to unlock value may not be optimal for many community-based projects.

  One model worth expanding on is the evergreen model for impact investing.[21] Evergreen funds provide a framework that either allows realised investment returns to be partially or entirely recycled back into a fund rather than distributed, or provides for some sort of annual dividend, reflecting a partial value, that could allow investors to gradually extract some value throughout the duration of their investments. The obvious value here is two-fold: the evergreen model allows for investment in projects where it will be difficult to observe the true impact except over long-term frameworks. At the same time, investors could still obtain some measure of value and liquidity.

  Open-end funds provide another option. Again, the closed-end fund that is more characteristic of private equity is problematic for investors with liquidity concerns. But while open-end funds address this problem, they introduce a host of new problems that relate to when an investor enters into the project cycle.

  There needs to be far more creative thinking applied to these vehicles to make them viable for the South African market.

- Probably the greatest barrier to embracing impact investing in the South African arena relates to the most powerful of the gatekeepers: the asset consultants and advisers. Our consulting industry is particularly unevolved. Two hallmarks of the consulting industry in South Africa are its relentless focus on alpha and assessments based on past performance, and the low support for alternative and impact investments such as direct investments, debt and infrastructure. This means that consultants appear to give less attention to whether funds are meeting their long-term funding targets or fulfilling broader societal needs that will be of relevance in defining the type of world their members will retire into.

  Again, this may well be a function of three things:
  - an environment where market returns allowed the industry to be complacent about searching for additional sources of return
  - a constantly rotating trustee composition that demands governance and investment literacy issues be kept as simple as possible
  - limited investment in tools that would help consultants risk-budget effectively for the uncertainties that are potentially embedded in impact investing

    Asset consultants face almost identical challenges with private equity, direct property and infrastructure investing, yet they have not been nearly as hesitant in these domains. What's actually missing here is a deeper understanding of how both risk and return need to be managed at all times, in any portfolio. This means understanding the interplay of volatility, liquidity, exit timeline, investment style and the investment size of various investment opportunities. These same considerations will also be made when institutional investors approach an impact investment.

    Risk budgeting goes a long way to helping fiduciaries solve these types of problems when combining listed and unlisted investments into a long-term solution. The shocker for the South African asset consulting industry is how few asset-consultants even understand the basics of risk budgeting, much less help guide their clients through the process.

    The most important factor for getting the advisory industry to sit up and take notice will come when we can get a far better handle on those multiplier numbers: how much more impactful would direct investment into building a better future for South Africa be than investing in our listed companies?

Parting thoughts

These are bold ambitions indeed – but they speak directly to our vision for funding models in a well-being economy. That said, the concepts presented here may well represent a direct threat to a very well-entrenched industry. But they needn't.

There is absolutely no reason we cannot use the fundamental principles discussed here to shape a future for the asset management industry that better aligns the interests of all stakeholders and, as such, extends our licence to operate as an industry on our clients' behalf.

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