Realizing the Impact of Impact Investing

Impact investing is hot. Throughout the world, traditional investment firms, philanthropic foundations, and a new crop of specialized impact investing funds are promoting this new investment approach as a way to address social problems and make a profit. Brazil is no different.

In late March, I had the opportunity to visit Rio for the Global Entrepreneurship Congress, the world's largest gathering of organizations that promote entrepreneurship. This year's event, managed by Endeavor Brasil, offered a special day focused on social entrepreneurship and impact investing. While every continent was represented at the forum, Brazilians were there in force – and they were promoting their national impact investing sector.

Yet, while the sector is growing in Brazil, it is still very small. As in every other country in the world, social entrepreneurs and impact investors are facing three major issues to scaling their growth.

Lack of Good Deals

There are hundreds of thousands for small firms in Brazil, and thousands of them could credibly claim to be social businesses that are looking for capital. Unfortunately, they are hard to find for most impact investors. Many are still focusing their capital raising efforts on local banks, which don't typically offer equity investments and tend to respond unfavorably to small firms with few physical assets seeking growth capital. In Brazil, there is a lack of market-connecting mechanisms to link social enterprises seeking capital to investment funds and individual investors who could provide it. We can see a few solutions popping up like the platform Brazil's Impact Investment Exchange, BRiiX.

There is a more fundamental challenge that limits investment. Most social entrepreneurs in Brazil – and in all parts of the world – need significant business development assistance in order to scale. The typical successful social enterprise has an accomplished entrepreneurial leader at the helm, but lacks a strong upper management team underneath her. Another common challenge is a lack of true market understanding. When trying to serve base-of-the pyramid customers, it's difficult to obtain accurate market sizing information from public sources and very expensive to generate for a small firm. Investors are aware of these challenges and when they make investments, typically expect to provide support well beyond their capital contribution. However, they end up making fewer investments.

Lack of Investor Activity

As mentioned above, most blue chip investment funds, including big names like JP Morgan, UBS and Goldman Sachs have launched impact investing or social finance funds. According to the Global Impact Investment Network (GIIN) data, there are nearly 300 investment vehicles that are focused on small business entrepreneurs in emerging markets. However, the GIIN's most recent industry survey identified only US$8 billion in global impact investing in 2012. That's actually a tiny amount. It represents only 0.01% of the US$79.8 trillion of assets in professionally managed funds in 2011.[i] And the amount flowing to Latin America and the Caribbean is less than one third of the total tracked impact investment.

So, while the industry is growing, there is still not much activity relative to the need. Here again, there are some understandable reasons. The market infrastructure doesn't yet exist to facilitate investments. Unlike traditional equity investment asset classes, there are no easily available research reports tracking individual companies. And, the need to assess potential firms is even higher in impact investing because success needs to be measured in both financial AND social impact. There are notable efforts to address these challenges, including the development of the Impact Reporting Investment Standards IRIS and creation of the Global Impact Investment Rating System (GIIRS). But we've still got a long way to go.

Government Support

In Rio, a number of Brazilian government officials expressed their support for social enterprise. We can observe this advance with the creation of programs like Start Up Brasil, an entire Ministry for the Micro and Small Enterprises and the increasingly the support of institutions like FINEP in the impact investment sector. The same is happening globally, as the largest investors in impact investment funds to date have been bi and multilateral investment agencies like the International Finance Corporation and the InterAmerican Development Bank. They have been helpful catalysts. However, for this nascent industry subsidy is still necessary, both from national and international public sector sources.

Microfinance has been the beneficiary of nearly $16 billion in subsidized capital.[ii] That dwarfs the support that has been extended to funds and entrepreneurs focused on addressing social challenges. Yet, the potential return on this support is even greater, as small entrepreneurial firms, unlike microenterprises, have the potential to grow and create millions of new jobs. In particular, more support is needed for talent development and firm-focused capacity development. Further, governments should work closely with other intermediaries to help build markets for social innovations by serving as pilot customers and providing risk guarantees to impact investors.

Optimistic Brazil

One of the things I love about Brazil is how optimistic the people are. I'm amazed at how many ways that Brazilians have to say things are great – tudo jóia, tudo bem, tudo bom, tudo legal, tudo ótimo and that "mais ou menos" is about the most negative response you'll ever hear. Now sometimes that optimism is misplaced – but not in this case. Brazil is legitimately a hot spot for global emerging market impact investing. Both the quality and quantity of social enterprises is improving. And so too is the number impact investing funds and social entrepreneurship focused incubators operating in the country. Increasingly, existing investors are expanding out of Southern Brazil into the Northeast.

So, there are a lot of challenges to still overcome, but at least Brazil is building a critical mass of players to address them. Brazil may have "lost the pope", but it is likely to win in impact investing.

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[i] TheCityUK - Fund Management 2012

[ii] See Due Diligence: An Impertinent Inquiry into Microfinance, by David Roodman