# FOMC - Special

Investment Theme "Impact Investing" – 01 May 2012

As a result of the increasing demand for information in the family office market, Family Office Management Consulting publishes its quarterly newsletter as well as ad-hoc specials and briefing notes on various subjects relating to the family office theme. The selection of topics results from the experience in working with families, entrepreneurs and family offices on a daily basis, current developments in local and international markets as well as on requests by clients.

## "Entrepreneurial" philanthropy?

In light of the continuing turbulences and current insecurities in the market, family offices and private investors are strengthening their search for alternative investment opportunities thereby not only focusing on entrepreneurial investing in the strategic, venture and direct investment spheres, but also exploring new investment themes such as SRI, micro-financing and impact investing.

### *A new field for family offices*

Whereas institutional investors have discovered this investment space already since quite some time also in an effort to diversify across asset classes and regions, for family offices practicing direct or indirect "impact investing" has an even deeper meaning related to one common theme – the unique combination of entrepreneurship and philanthropy.

Philanthropy is by tradition associated with family offices, business families and entrepreneurs, not only in recent times through the Warren Buffets and Bill Gates of this world. Philanthropy is seen as one of the pillars in the establishment of a family legacy. Supporting a good cause via the family's own foundation or institutions traditionally related to the family or even via the family business is common practice, often combined with the involvement of the next generation in such activities.

Philanthropy is however changing in its very concept. With foundations having multiplied over the past decades with active management being in all cases by now a given, the latter development seemed to have been the beginning of a transition into an even more hands-on approach; and it is exactly at this point where the notion of "entrepreneurship" comes into play. The greatest value of a business family, respectively founding generation owners is the "entrepreneurial spirit", which nowadays transcends into the philanthropic activities as well. Running charitable institutions including foundations, just like a business has long taken over from simply "giving money".

Although philanthropy has for a long time served as a vehicle for bringing the family together through common family projects, also by involving the next generation, is has never been seen as "entrepreneurial project" in its own kind, even comparable with private equity investments as it is nowadays; with a long-term perspective on growth and first and foremost on making an impact, thereby again strengthening the family's stronghold and legacy.

### *Putting theory into practice – easier said than done*

All of the latter - a nice concept in theory, however, the practice is still to some extent lagging behind, apart from a few exceptions – a number of pioneer entrepreneurs and their family offices who have made it their mission to establish SRI portfolios on a comprehensive basis, invest in and run their very own social entrepreneurship or micro-financing projects; all in an effort to not only grow, but leave a lasting footprint in this world and for the next generation. The remainder is currently taking it one step at a time with education and to some extent handholding being needed as not every one has a seasoned in-house team of experts at their hands to establish and run own projects and funds. On top of this, the landscape of providers and managers is constantly growing, although only very few stand out so far as strong market players with a considerable project pipeline, seasoned due diligence teams and the expertise to deliver results. Results that will still need to be seen and moreover be defined.

### *So what's the impact?*

It is particularly in regard to the latter aspect where the focus has shifted to in recent years and where family offices are taking a closer look as well. Which investment results are to be expected and how can philanthropic impact be measured? As with family office operations in general, efficiency and benchmarking has become an overriding theme and also in the field of philanthropy, be it via projects or an investment approach, measuring actual investment impact takes on an important stance.

While the number of tools and methods is constantly growing, only a few have been recognized so far and even less can be implemented in-house and plugged into the family office infrastructure itself.

Impact Finance Management in Geneva, our guest contributors to this month's Special, have not only built their track-record over the years in the field of impact investing, but are also amongst the pioneers of looking closer into impact measurement having developed their very own unique measurement system.

Family Office Management Consulting Ltd.

33 St. James's Square London SW1Y 4JS Telephone +44 (0)20 3170 5966 Fax +44 (0)20 3170 5967 contact@fo-mc.com www.fo-mc.com

## Guest contribution

*Cédric Lombard and Fabio Malanchini teamed up in May 2010 with the creation of the Geneva-based firm Impact Finance Management that launched not only successfully its first fund in September 2011, but also stood out through the invention of its very own Impact Monitoring System, Kharmax. Clearly a large part of Impact Finance Management's success story is based on the long-term experience of the two managers and entrepreneurs themselves in this still widely unknown and to be discovered new investment field – with Cédric Lombard previously co-founding BlueOrchard Finance in 2001 and Symbiotics in 2005, both microfinance fund managers, and Fabio Malanchini being the co-founder of Microfinanza and Mircofinanza Rating, the biggest rating agency specialized in microfinance and leader in social rating.*

In the following featured guest article Cédric Lombard gives insights into Impact Finance's background, operations as well as the company's innovative approach to impact monitoring.

### *What is Impact Investing?*

Somewhere in between Socially Responsible Finance and Philanthropy a new way of investing is slowly emerging: Impact Investing. It combines two central desires – firstly, "demonstrating responsibility" and secondly, "making a difference" or an "impact". Impact investing provides a new perspective to the meaning of investing, providing a fair return, coupling accountability and sustainability in the investment approach and the generosity and altruism of the donation.

Microfinance has certainly been a pioneer within this emerging investment field, with the impressive build up of a funding industry from a few million USD at the end of the 90's to a USD 7 billion industry ten years later. It however never fully satisfied the aim of the investors, as microfinance (the provision of tiny loans to the Base of the Pyramid (BoP)) has been increasingly treated as some sort of panacea and therefore an end on its own, when it should have been regarded purely as a means to an end, development.

In some countries such as India or Nicaragua, this error of judgment created problems of over indebtedness leading to even greater poverty and despair. These crises in 2009-10 led however in turn to an increased consciousness on the importance of focusing on tracking actual impact as much as on the financial results per se and moreover finding ways for the managers to put as much importance on impact as on risk.

### *What is Impact Finance?*

Having worked 10 years in the microfinance fund industry, my co-founder Fabio and I decided together to found in 2010 a new company that would enable us to follow this trend. Since then we have launched a small Group - *Impact Finance* manages an open-ended fund based in Luxembourg with quarterly liquidity and aiming for a return similar to those delivered by microfinance debt funds. It provides mainly debt to companies within value chains that generate a positive social, economic and environmental impact at the Base of the Pyramid. The idea is to finance the cash flow of these companies with the aim for them to grow and replicate their model. The fund started with an initial USD 3 million in September 2011, reaching USD 5 million in March 2012 and aiming to grow by USD 15 to 20 million a year

In addition, we have created an impact monitoring system, providing us with the possibility, together with the funding, to give added value to the "meaning"; an efficient tool that enables us to benchmark the impact of our companies. This system has been span-off so it can be offered as a stand-alone tool to anyone interested in impact monitoring via the company *Kharmax Impact Monitoring System*. Finally we have set up a small department within the Group called the *Incandescent Lab* that supports projects to plan for scalability and become investable.

Kharmax is the convergence of a long-standing reflexion on the impact of microfinance and of the necessity to track impact within a project's value chain. Kharmax uses an innovative methodology to assign indicators to the relevant actors in a company's value chain. The data is then used to calculate the scores for the seven impact categories. The system has been conceived as a web-based self-reporting instrument. It primarily aims at providing the company with a management tool to monitor their progress and to communicate such internally to their employees, board members and shareholders as well as externally to additional stakeholders, such as providers, clients or funders. The tool in turn enables us, as a funder, to define objectives and closely discuss with the companies particular aspects of their impact, point out opportunities for optimisation, as well as communicate actual impact to their investors.

## *Where does Impact Finance invest?*

Going forward, the fund will invest in different sectors such as water and sanitation, renewable energies, food and agriculture, social housing, and education. The investment universe is vast but the continuous focus remains on the integration of the BoP in the value chain. Our first investments were quite different with the fund, for instance, making a loan to the biggest fair trade gold mine owned by artisanal miners in Peru. This project eliminated child labour and initiated the production of the mine's own gold in order to create value. Our loan enables them to process 300kg of gold a year, so the mine now operates at its full capacity while previously only one third was processed. Other loan projects include financing energy efficiency loans in rural Kazakhstan, loans to an environmentally friendly water filter producer and retailer in Cambodia, as well as a loan to a coffee shop in Switzerland buying directly from producers and roasting its own coffee of origin. With a pipeline of over 250 companies built over the last two years and a half, we are fairly confident to be able to lend to 5 to 10 companies a quarter.

The fund is mainly addressed to families and private investors seeking to invest their funds in a meaning-full and sustainable way with full transparency. In addition the fund aims to provide investors with a unique opportunity in terms of diversification as it focuses on the BoP where future development is key.

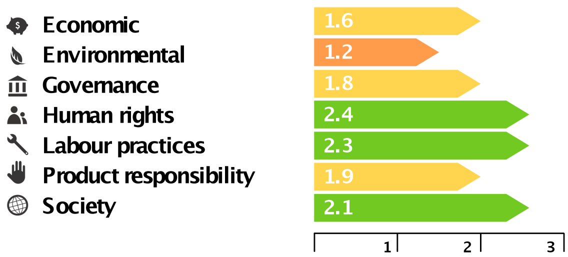
## *Example of an impact analysis*

Sotrami's value chain is very attractive in terms of impact. It received a fair trade and fair mine label in 2011, and is herewith one of the first projects in the world to receive it. In terms of economic impact, the integration of the ore transformation process has enabled to increase the income of the 1'000 miners working in the mine thus to raise their standards of living. Moreover, it has allowed women to focus on other economic activities given that the village is continuously growing a local economy. A ten-year collaboration with different organizations such as the International Labour Organization and the Swiss Development Corporation has led to the complete ban of child labour and a dramatic improvement of health and safety conditions of the miners.

Environmentally speaking, the mine has adopted a standard technology of cyanidation that is less harmful than the use of mercury in traditional artisanal mining. The cyanide is managed in a closed circle and because of the extreme dryness of the region, the risk of aquifer contamination is very limited. Energy production using a diesel power plant emits a substantial volume of greenhouse gases and aerosols, but the company intends to invest in a connection to the grid or in a solar power plant in 2012.

IMPACT FINANCE FUND

Project SOTRAMI – KHARMAX SCORE




Family Office Management Consulting Ltd.

33 St. James's Square London SW1Y 4JS Telephone +44 (0)20 3170 5966 Fax +44 (0)20 3170 5967 contact@fo-mc.com www.fo-mc.com