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EMERGING MARKETS

Impact from the ground up

Mainstream impact investors may be grabbing the headlines, but local issues need local solutions. These can only be identified and addressed with teams on the ground and a tailored approach, says impact investment manager Incofin

Impact strategies are developing fast as investors become increasingly interested in committing capital for financial, social and environmental gains. The entry of large, mainstream players has gained significant attention, with arguments suggesting that the bigger the ticket size, the greater the impact. However, evidence suggests that taking a global and macro investment approach to impact investing does not work without a tailored, nimble and localised investment strategy that addresses the issues of the communities.

Incofin has over $2 billion invested in impact strategies focusing on financial services and agri-foods in emerging markets, with teams in Cambodia, Colombia, India and Kenya as well as an Eastern Europe/Central Asia team based at its Belgium headquarters.

We spoke to four of its senior executives – Aditya Bhandari, partner and co-head of Asia, David Dewez, partner and head of Latin America and the Caribbean, Rahul Rai, partner, India and Elizabeth O'Reilly, managing partner – to get their perspective on what it takes to make successful impact investments off the beaten track.

> ***We reached 33 million end beneficiaries of which 73 percent were women***
>
> **Elizabeth O'Reilly**

Q Some might say that impact investing is something of a fad. What would you say to that?

David Dewez: Incofin has driven impact investing for more than 18 years and we are convinced of the long term necessity of impact by the private sector. We have a proven track record demonstrating both positive impact and good returns. With more players entering the market, there could be some risk of 'impact washing' – thus it is important that the impact industry apply transparent and tangible impact measurement methodologies.

Q How does Incofin apply impact in its investment assessment?

DD: The Incofin impact methodology and associated impact due diligence tools have integrated industry best practices. When conducting due diligence on portfolio companies' environmental performance, we check compliance with forbidden international practices (eg, environmental and social exclusion lists and protection of conservation areas). We also value companies that proactively put in place green strategies, such as loan products linked to investments in energy efficient assets. Moreover, we supported several entities mitigate and adapt to climate change, such as financing coffee and cocoa producers to renovate their crops with more resilient trees.

Elizabeth O'Reilly: We measure impact metrics and, at the same time, work for strong financial returns. Last year, Incofin's financial service sector investments reached 33 million end beneficiaries, of which 73 percent were women. Agri-food investments led to a 10 percent increase in yield with an outreach to over 250,000 smallholder farmers.

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> **David Dewez**

Rahul Rai: Of our agri-food investments, 100 percent of the portfolio companies promoted environmental standards by providing training on topics relating to climate change. Further, 81 percent of the co-operatives financed were engaged in organic practices.

Q So how is it possible to address local market needs and have access to global expertise?

Aditya Bhandari: We believe having local staff to understand the cultural and business environment is key to recognising the needs of the end customer and identifying investment opportunities with real impact. Our investment managers are specialists in financial services and agri-foods and regularly share learnings via 'cross fertilisation' across the global Incofin network.

DD: Our Fairtrade Access Fund (FAF) aims to promote the development of a »

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» fair and sustainable agriculture sector, availing of a dedicated team with specialist knowledge in each of the 12 different crops, including coffee, cocoa and Brazil nuts, and the regions in which it invests.

For us, sustainable agricultural development concerns not only food security but also the effects of climate change, and inclusion of smallholder farmers. FAF bridges the much needed long-term capital needs of climate change adaptation and mitigation projects, such as crop rehabilitation, diversification and adoption of new and more efficient technologies and infrastructure.

To date, FAF has financed more than 65 institutions supporting over 260,000 smallholder farmers, leading to an annual $250 increase in income per family.

Q Where do you see the next exciting opportunity for impact investing?

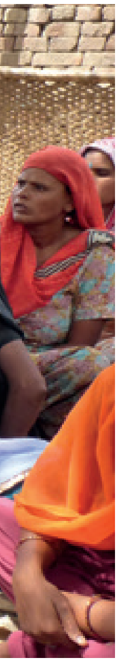
EOR: In line with developing funds that address specific gaps in the market, we will be focusing the upcoming India impact fund on investments in 1) financial services providers that help promote financial inclusion in underserved populations and 2) businesses that use technology and innovation to drive efficiencies and disintermediation in the agri-food value chain.

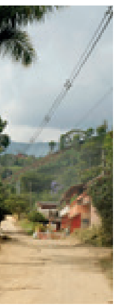
AB: With only 60-80 million Indians estimated to be positively impacted by impact investing, there is still a pressing need for casting the impact net wider to help lift millions of people from poverty. We are focusing on financial services as India is the second most underbanked country in the world, with 190 million citizens lacking bank accounts. The microfinance market is well established in India; we are investing in businesses targeting the underserved and rural areas through alternative lending channels such as peer-to-peer lending, non-banking financial companies and innovative digital solutions.

> **Addressing challenges in agriculture in India is critical to making a tangible impact**
>
> **Rahul Rai**

RR: In addition, addressing challenges in agriculture in India is critical to making a tangible impact. Despite India being the third largest agricultural producer in the world and supporting the livelihood of 53 percent of the population, the sector is constrained by supply side challenges attributable to sub-optimal crop productivity and multiple levels of intermediation between farmers and consumers. With a capital plus knowledge model, we can make focused interventions in the agri-food value chain to make a significant impact by addressing bottlenecks in increasing entrepreneurship

***Going local:** whether it is Indian microfinance, Colombian coffee or agri-tech projects, fund managers need to have teams on the ground*





and self-sufficiency. We see companies in the post-harvest value chain (eg, collection and handling, warehousing, processing, distribution) well placed to leverage this opportunity.

Q Given your investments are often off the beaten track, how can you source these opportunities?

AB: Sourcing deals relies on our local presence and our people travelling well beyond the urban centres, often overlooked by many other investors. These are also often businesses that aren't market-ready: they might be family-owned, face specific challenges or are not yet fully established. Even if other investors find them, they may not be interested in spending the time to develop the necessary relationships. Over 90 percent of our equity investments in India have been sourced directly by our local investment team's network and we average three executed deals per annum. We seek to go to underserved areas and invest time to create true value creation.

Q Can you give an example of how strong relationships can help in sourcing deals?

AB: One of our recent successful exits, Fusion, a microfinance institution, was sourced on the basis of our strong relationship with the entrepreneurs. We met the founders of Fusion as they were seeking to establish their business in 2010, to provide finance to unbanked women living in the rural and semi-urban areas of northern and central India. Fusion turned out to be a great investment that grew its loan book from \$900,000 to \$100 million while serving more than 1.3 million women customers, compared to 2,648 at the time of investment. There were, however, challenges along the way – for example during the Andhra Pradesh microfinance crisis in 2011, there was a freeze in debt and equity capital markets. To strengthen the balance sheet and enable the long-term growth of Fusion, Incofin capitalised the company with \$1 million. Fusion considers this to be the most critical capital they have raised and shows how we support portfolio companies through challenging periods of growth.

Q Can you provide an example of how your investments have had not only a social, but also an environmental impact?

DD: Incofin provided long term financing of \$3 million for an environmentally sustainable wet mill project to De Los Andes Cooperativa, a small coffee producer in Colombia with a focus on achieving fair pricing for farmers. Traditionally the wet milling and drying of coffee is a labour intensive effort, requiring involvement from most of the family members, resulting in important opportunity costs and negative environmental impacts. The community wet mill centralises this process and farmers receive a premium for better quality produce. Further, the cash conversion cycle is reduced, enabling farmers to pick and sell coffee berries on the same day.

Moreover the post-harvest coffee process has traditionally been extremely water-intensive. To produce one kilogram of parchment coffee, over 44 litres of water is consumed, which subsequently flows into the rivers, contaminating it with fermentation waste. The new wet mill aims to save an annual 50 million litres of water and treats the water being entered into the river.

Q What role can technical assistance play?

DD: We provide capital as well as specific support to portfolio companies to help strengthen capacity in different areas. For example, we supported two local microfinance institutions to create an agricultural insurance product that boosts the resilience of smallholder farmers in Nicaragua to the effects of climate change, such as drought and excess rain. It's the first product of its kind that considers the specific characteristics of the Nicaraguan market and climate.

> ***India is the second most underbanked country in the world***
>
> **Aditya Bhandari**

Q How can technology create impact in investments?

RR: The last few years have been an exciting time for entrepreneurial activity in India and we are seeing more innovative solutions coming through in the more traditional areas of the economy. For example, there are interventions that are seeking to facilitate trade between India's 6,615 regulated agri-wholesale markets to the 23,000 smaller informal markets. Ventures such as these will help reduce price distortions and secure better outcomes for producers and consumers alike. Many young entrepreneurs are deploying technological solutions to bridge this gap and we intend to support such ventures that create a win-win solution, via agri-cold chain models, frugal storage solutions, agri-produce testing and certification etc.

Our recent investment in Sohan Lal Commodity Management enables a holistic approach to the vulnerable post-harvest Indian agriculture segment. The company has a patented box product: combining technology and process-led disruption, Sohan Lal enables the farmer ecosystem to reduce crop wastage from 10 percent to 0.5 percent (a 95 percent saving) which has a positive impact on farmers' income and the environment. We are seeing similar interventions across the agri-food value chain at a scale not seen before. ■