Q&A: Jupiter Impact Partners' Melissa Kang

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Melissa Kang helped raise Morgan Stanley's first global impact fund before striking out on her own with Jupiter Impact Partners. She explains why Southeast Asia should prove fertile ground for the strategy

Q: What took you from the International Finance Corporation (IFC) to predominantly impact-focused role with Morgan Stanley?

A: In 2012, Morgan Stanley, like many other large financial institutions, was looking at the challenges the world was facing and how they could play a role to help as gatekeepers to large pools of capital. Many of their clients were looking at the impact space, so they recognized an opportunity. In 2014, it decided to strengthen its exposure to emerging markets alternatives and find a team that had successfully invested with ESG [environment, social and governance] and impact with positive financial outcomes. They recruited David Wilton, who was my manager at IFC and he invited me to join him. There were four of us in total from IFC and we launched the first global impact fund.

Q: And then various others entered the space…

A: We were the first impact fund-of-funds, making primary fund commitments and participating in secondaries, co-investments and some direct deals. Around the same time, Goldman Sachs acquired Imprint and Siguler Guff hired Jay Koh from OPIC. Different people were coming out with different ideas. Partners Group started PG Life in 2016, Bain Capital launched Double Impact, and TPG Capital established The Rise Fund. Fundraising was not straightforward. Family offices were ready to invest. Large insurers like Zurich and Axa were ready, but due diligence took a long time because it was a new strategy. Pension funds were not so interested, and they didn't want to back funds as small as $300-400 million. We closed at $126 million in 2017, anchored by an insurer and raising the rest raised through private wealth channels. People didn't think that was so big, but when I compare it to others, we did quite well. Credit Suisse partnered with UOB and raised an impact fund of $55 million. PG Impact raised $210 million but that included some internal capital. TPG was able to raise $2 billion and I think one of the contributing factors was it's an independent fund manager, not a large investment bank. When they want to launch a fund, all efforts are channeled in that direction. Large-scale banks and asset managers have dozens of funds on the table across all kinds of asset classes. It is hard to get the attention of marketing people as a mid-cap first-time fund.

Q: What led you to establish Jupiter Impact Partners?

A: The Morgan Stanley fund has performed well above its benchmark and I would say a significant portion of that came from Asia. After six years of research, it was clear to me that the region offered interesting opportunities for impact investing. If we want to attract mainstream capital into impact, investments must be financially viable, and Asia can deliver competitive commercial returns. At the same time, Asia has a lot of ESG challenges that need to be addressed. China, India and Indonesia are the three biggest contributors of carbon dioxide emissions globally. Asia's share of health issues and food safety issues is off the charts, much larger than its population share globally. I believe the only was to do it is to build an independent fund manager. I discussed it with a few former colleagues who have ESG and relevant sector experience and we started working on a pipeline of deals that would meet impact investment criteria. To execute this, we put together a team and launched Jupiter Impact Partners.

Q: How do you quantify the opportunity set in Southeast Asia?

A: Between 2007 and 2017, impact investment in Southeast Asia reached $12.1 billion, according to the Global Impact Investing Network. Development finance institutions contributed $11.2 billion, with $904 million from private investors. Of that investment, 80% was in the form of debt. And when you look at where the money went, about 65% was for micro lending and financial inclusion and 35% was shared among education, healthcare, agriculture, and water. We also did a landscape study of Southeast Asia and found that, while there have been a number of impact funds, most of them are sub-$100 million and sponsored by family offices based in the West. Many are either single strategy or sector agnostic. They also have limited resources to implement anything above minimum ESG standards. We could see there was a gap in the mid-market for companies seeking to raise $5-15 million and we identified five sectors we believe are important yet underserved: food, circular economy and water, climate change mitigation, healthcare, and education.

Q: What are your investment criteria?

A: Our investments must contribute to at least one of four of the UN sustainable development goals: good health and well-being, clean water and sanitation, responsible production and consumption, and climate action. After that, the first pillar is the commercial viability of a company – whether it is owned and run by professionals, whether it has been growing, whether it will be able to grow at 20% a year for the next five years, and whether the business model can be scaled. The product or service must also be targeted at low to middle-income groups in Southeast Asia. The second pillar is the ESG exposure of a company. Airlines would be category A, e-commerce would be category C, and most of the companies we look at are category B, which is medium ESG risk. We ask whether we can make improvements in this area. The third pillar is impact. What is the implied impact of a business? Is the impact relevant and it is measurable? If so, how can our capital maximize that impact? Our team's compensation is tied to this triple bottom line.

Q: Are you considering other geographies as well?

A: Southeast Asia is phase one. We have plans for how we will address other parts of Asia. We will not launch a pan-Asian fund. Our skillset is East Asia – Southeast Asia, China, Japan, Korea. We are not keen on South Asia because we don't have the skillset to invest there and then India in particular is a very crowded space.

Q: Apart from check size, what makes you different from global impact funds?

A: Their decisions are ultimately made in the West, for us it is in Asia. The key people are all here. We are Asian and we have our networks. In addition, we are focused on a few sectors, while most global funds are sector agnostic. This means we can work with companies systematically, based on a knowledge of what kind of resources they need and how to help them to move to the next stage of their growth.

Q: What are the challenges in pursuing an impact strategy with small and medium-sized enterprises (SMEs)?

A: The impact is us, not the company. The company is simply pursuing a business model that meets our criteria for high impact. They need financial support and there aren't many funding options. If they can't get funding, they don't invest in human capital and so attracting talent and financial management become problems. We utilize private equity discipline when making impact investments. We want to transform high growth companies into sustainable businesses, so they can grow even faster and qualify for bank financing. Good financial structures and ESG practices can also make them employers of choice. Talented people often avoid SMEs because they don't see a future, or the pay is no good. If you can articulate the value of being part of that company – emphasizing the contribution it makes to society – you might be able to retain interesting talent. Ultimately, as the company is operating in one of our target sectors, serving a large population of low and middle-income consumers, growth will generate net positive impact, if the ESG exposure is also well managed.

Q: How difficult is it pitching a Southeast Asia impact strategy to LPs?

A: A lot of international investors are surprised by how large and young Southeast Asia is. Most of them have been focused on China, India and maybe Japan. Broadly speaking, investors can be divided into two groups. The first group has experience of impact investing and it hasn't necessarily been a good experience in terms of financial returns. The second group has no experience, but I don't think you need a designated impact strategy to make investments. Do they want to target growth areas that are underserved or where there is a dislocation of capital? If so, impact investing is very interesting. Having a contrarian view gives you a better chance of creating alpha.

Q: Is there a clear evolution from thinking about ESG to backing impact strategies?

A: It's the value alignment spectrum. At the beginning, you invest in anything. Then you move one step in, it's no longer about making money from anything, and you make a list of things you don't want to invest in. Many large investors are doing this today, selling off petrochemical, mining and plastics businesses. One more step and you start thinking about ESG risk. You identify those risks, categorize them, come up with a remediation plan and act on it. In emerging markets, where proper regulations are often lacking, ESG was supposed to ensure people adhered to international standards. It kept people out of jail and minimized the negative impact on the environment and society. However, regulation has since improved. For example, China now has very strong environmental protection laws and it enforces them. In developed markets, the standards are higher, so ESG efforts must be more proactive. Impact is the strictest form of socially responsible investing. It comes with intent. You need a rigorous ESG framework and implementation program, and there is a net positive impact you want to create. At this stage in Asia, many people have exclusion lists, but when it comes to ESG, in general, it is still light touch. It tends to be one sentence in the limited partnership agreement: the GP will take extra care on ESG measures. There are stringent performance standards or negative effects on the manager for breaching ESG protocols. Only the more sophisticated investors have that.