IMPACT INVESTMENT SWEET SPOT IN SOUTHEAST ASIA

"Many ancient philosophies view the world as a complex non-linear system with interrelated components. Any 'imbalance' within the chain may lead to a series of unintended consequences. Today, this 'alternative' world view has begun to creep into our public consciousness as societies are confronted with a range of environmental challenges. The current 'take-make-dispose' industrial model has proven wasteful and has created a set of 'externalities' in the form of social and environmental degradation"

- JI Capital Partners

Impact investing de-mystified

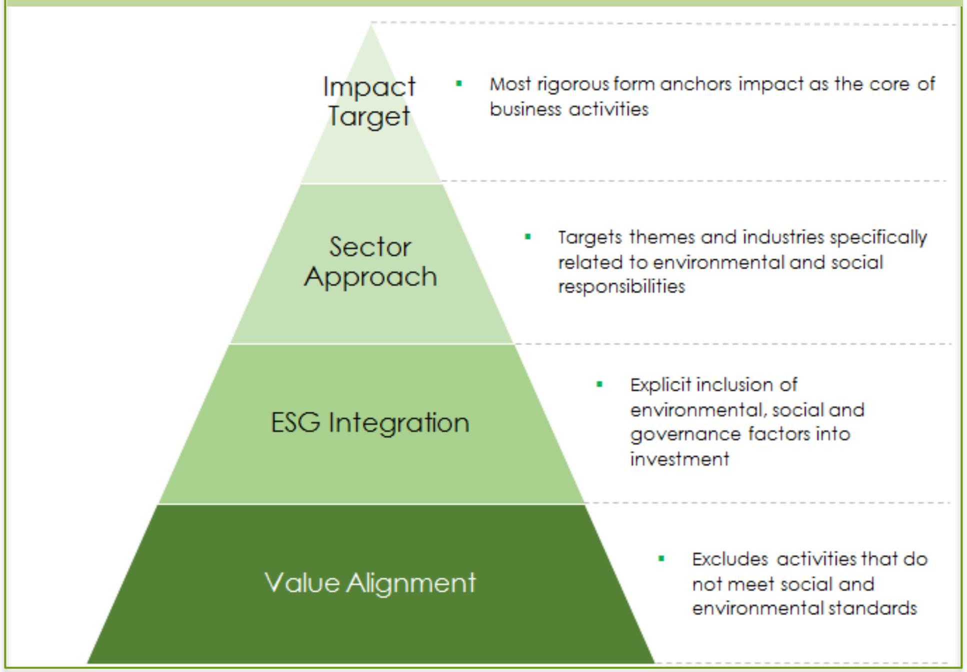
Impact investing has garnered growing attention among investors as societies have become more aware of social stewardship. Yet the practice is not well understood. Often, there is the perception that what is good for societies is not rewarding for investors.

In other words, impact investing is seen as a quasi-philanthropic activity whereby financial return is being compromised in the pursuit of social goals. There is also the **misplaced generalization of impact investing as grant / subsidy dependent activities** carried out by NGOs or state funded organizations. The subject lacks proper taxonomy with inter-changeable use of a plethora of terms such as sustainable investing, ESG ('environmental, social and governance) and socially responsible investments ("SRI") to name a few.

Globally, the **commitment level will only increase with time**, with more funds moving up the pyramid. The 2007 financial debacle has led to the realization that investing for pure financial pursuit is socially inequitable and not sustainable. Since then, the growing concerns over a multitude of social-environmental issues triggered by several major global disasters (Exxon oil spills, Katrina hurricanes and Fukushima Daiichi nuclear accident, Hurricane Harvey) have further incentivized investors to embrace a more sustainable approach towards capital allocation.

In Asia, impact investing, along with the broader themed SRI, **is still at its nascent stage**. But we are optimistic of the prospects. We believe that Asia, given its unique set of social, economic and environmental drivers, will be an important player in this movement.

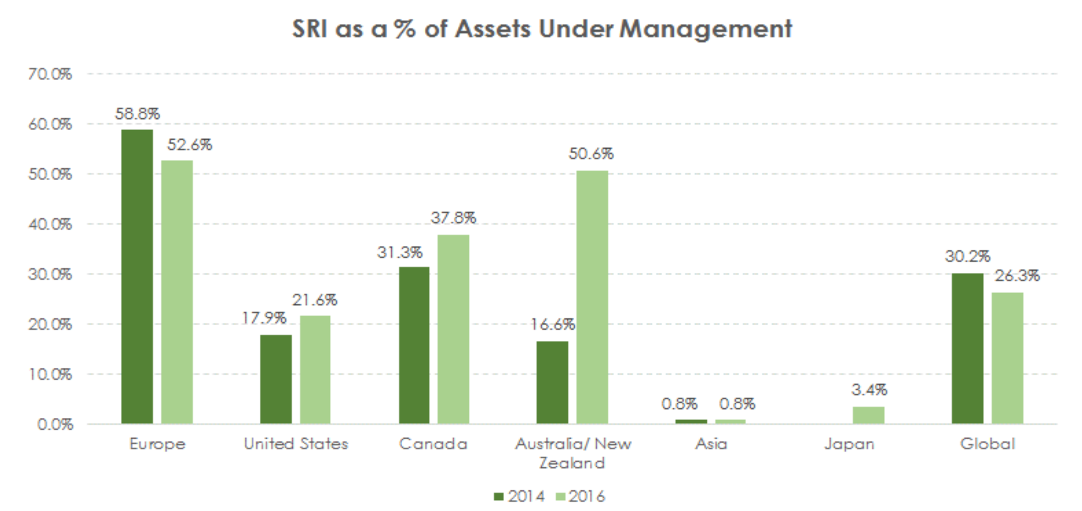
The pyramid of socially responsible investing



Source: Sustainable Investing – Imperative and Opportunity, Morgan Stanley, 2015, www.morganstanley.com

Impact investing to accelerate in Asia

Asia grossly under represented but will play catch up



Note: Asia figures include Japan in 2014 but exclude Japan in 2016. Eurosif used a narrower definition of SRI in 2016 than in 2014.
Source: Global Sustainable Investment Alliances

As of 2016, **SRI assets stood at US$23 trillion representing 26% of total AUM worldwide**, up from 17% a year ago. Europe took the lead accounting for 52% of the pie, followed by the US at 38%. In the US, SRIs account for about 22% of total AUM and rising at a faster pace than their peers in Europe[1]. The level of involvement in this asset class in Asia is still low, at less than 1% of AUM. Such gross under representation especially when viewed in the context of the region's looming social and environmental challenges means **Asia needs to play catch up**![2]

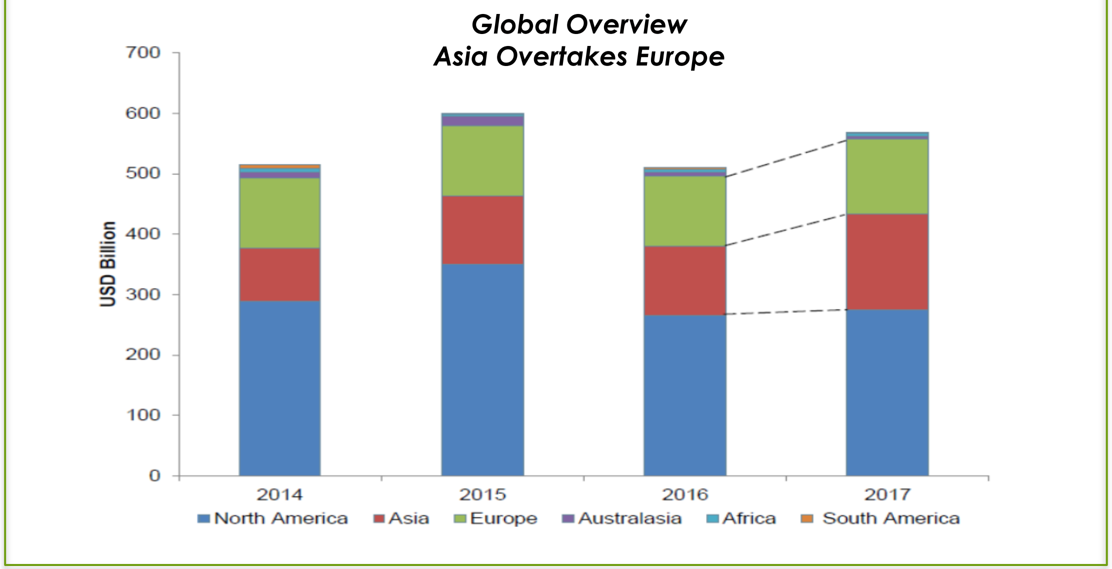
Already, this process has begun. **Asia's government pension funds are taking the lead on this front**. Japan's Government Pension Investment Fund, the world's largest pension fund, tripled its ESG investment allocation to 10% in July 2018. Similarly, pension funds in South Korea and Taiwan have both pledged to increase commitment in this space. Japan accounts for some 90% of the total SRI AUM in Asia estimated at US$526 billion.

Ex-Japan, SRI AUM was estimated at US$52 billion, having grown 16% from 2014 to 2016. Excluding Shariah-compliant funds, the total SRI AUM stands at US$34.2 billion, mainly led by Malaysia (30%), Hong Kong (26%) South Korea (14%). China, at 14% of total SRI AUM in Asia-ex Japan, is the fastest growing market, having grown 104% during 2014-2016.[3]

[1] Source from US Social Investment Forum [2] Source from Global Sustainable Investment Alliance; www.gsi-alliance.org [3] GSIR 2016 annual report

The High Impact Potential of Private Equity in SMEs

A Rising Private Equity Market



Source: Prequin

We believe that the best approach to maximize impact outcome and financial return is to focus on the under-served SMEs via the private equity ("PE") route. The **SMEs in Southeast Asia are some of the fastest growing entities** but often the ESG standards are lagging - thus providing opportunities for experienced impact fund managers to close the ESG gap.

Global PE market has had a strong up cycle for 8 years. 2017 was a bumper year with a total of US$569 billion invested, representing a y-o-y growth of 11.5%. While the US continued to command a lion share of 48% of total PE market, **investments into Asia grew 37.6% y-o-y to reach US$158.4 billion, surpassing Europe for the first time.** More specifically, investors deployed US$23.5 billion to the Southeast Asia, a record level according to SVCA[4].

PE provides arguably the best route to effect ESG changes and to ultimately attain greater social and environmental goals. High growth SMEs tend to be privately held and often many of them do not have clear succession planning. Majority of them have yet to reach global ESG standards due to resource constraints or simply a lack of knowledge. Providing the capital hungry SMEs the necessary funding accompanied by active management guidance on operations and ESG practices will help unleash their full potential. Due to SMEs' high job creation propensity, the social and environmental impacts generated can be disproportionately larger than returns from their listed peers.

[4] SVCA, Southeast Asia PE & VC investment Activity, May 2018

The “Focus Five” & SDGs alignment

Agribusiness & Food	Circular Economy & Water	Climate Change Mitigation	Healthcare	Education
• Access to food that are safe & traceable • Rising demand for proteins and plant based diets for better health • Increased regulatory standards to govern unsustainable fishing practices, overuse of pesticides and substances in farming	• Urbanisation and income growth will increase water consumption and wastes • Opportunities in material & packaging innovation to reduce waste, waste recycling into secondary materials & energy, water recycling, water treatment, desalination, river management	• Urbanisation and income growth will drive energy consumption • Technology advancement and cost reduction will make distributed energy more competitive • Energy efficiency reduces emission & operating cost • Waste-to-energy, biomass & biogas solutions provide climate change mitigation	• Ageing population and population growth in SEA – continue to drive up cost of healthcare • Opportunities in technology, innovative healthcare access & alternative delivery of care to improve accessibility and affordability	• Current education system no longer meet challenges in labour market • Opportunities in affordable education, vocational training, teacher training • Leveraging on AI, big data, e-learning to improve accessibility and affordability

Source: JI Capital Partners

Our studies show five sub sectors offer most compelling investment opportunities within the Southeast Asia SME context and at the same time offer high alignment with United Nation’s Social Development Goals:

- **Agri-food**: Food safety and traceability, organic food, plant-based diet, sustainable farming and aquaculture
- **Climate Change**: Access to clean energy, energy efficiency, emission reduction solutions for industries and transport, sustainable buildings, climate resilience
- **Water & Circular Economy**: Access to clean water and sanitation, water and material recycling, waste management, waste-to-energy, biomass and bio-gas solutions, innovation in material and packaging
- **Affordable Healthcare**: Access to affordable healthcare, preventive healthcare, innovation in clinical trial, homecare monitoring platform
- **Affordable Education**: Access to affordable education, education technology, mobile learning, inquiry-based learning

Conclusion

With increased awareness of social stewardship, SRI will continue to gain prominence globally. Asia is a huge laggard in this respect, with SRI accounting for less than 1% of the region's AUM.

But Asia is fast catching up, accelerated by efforts from local pension funds as well as the rising public awareness of the region's social and environmental challenges.

Impact investing, the most rigorous form of SRI, which anchors social and environmental impact as the core activities, may well be **the investment sweet spot in Southeast Asia.**

The region's divergent set of social, economic and demographic factors offer a fertile ground for impact opportunities.

More specifically, **impact investing via the private equity route targeting the under-served SME segment possibly presents the best impact outcome**. This is because SMEs possess high job creation propensity and yet many of these enterprises have not reached their full potential in ESG practices. In addition, as the average private equity deal size expands, the sub US$20 million category is being overlooked.

Five themes stand out – **food**, **climate change, affordable healthcare**, **affordable education and circular economy**. The combined net positive impact that could be generated through the economic activities in the five focus sectors that are implemented with a high standard of ESG considerations, will significantly benefit the overall well being of the human capital in Southeast Asia, and at the same time contribute directly and meaningfully to nearly every single of the United Nation's SDGs.

PLEASE EMAIL: INFO@JICAPITAL.ORG TO REQUEST FOR THE FULL WHITE PAPER

Copyright and Confidentiality

Registered Address: 50 Armenian Street, #02-01, Wilmer Place, Singapore 179937.

Company Registration No: 201839125H

Published in March 2019

50 Armenian Street, #02-01 Wilmer Place, Singapore 179938
+65 6904 3726
info@jicapital.org
www.jicapital.org