SUMMIT AFRICA

Can Impact Investing Provide Fair Returns for Pensioners?

9 Key Features for Effective Strategies

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ABSTRACT

At the recent 2024 Batseta Winter Conference, local and global experts gathered to explore how retirement funds can meet climate goals and social development needs while ensuring fair returns for pensioners.

Summit Africa ("Summit" or "the Group"), is a black-owned and managed impact-focused investment manager that is passionate about providing private market investment solutions that deliver above-benchmark risk-adjusted financial returns while contributing meaningfully to the Social and Economic Development of local communities.

In the last edition of the African Investing for Impact Barometer by Riscura and UCT Business School, Summit was recognised as a Top Private Equity Manager in Sustainability Themed Investment and ESG Integration (out of 2,640 funds from 382 fund managers in Africa), and in 2023, Summit won the Super Returns Africa Best ESG Fund of the Year award.

This paper delves into nine key features that asset allocators and fund managers could consider and integrate into a private market impact investment strategy that aims to realise above market returns for pensioners.

KEY HIGHLIGHTS

- Can Investing-for-Impact deliver a fair risk-adjusted return for existing and future pensioners?
- Nine features to integrate into a private market impact investment strategy that require an above market return.
- A case study on Custom Capital Finance.

Can Investing-for-Impact deliver a fair risk-adjusted return for existing and future pensioners?

In 2013, the World Economic Forum (WEF), in collaboration with Deloitte, released a report that provided a market assessment and recommendations for how mainstream investors can more actively engage in impact investing.

The report was the culmination of a year-long research initiative of WEF's community of investors and industry players, which included over 150 mainstream investors, business executives, philanthropists, research institutions, and policymakers, such as Goldman Sachs, JP Morgan, Morgan Stanley, Duke University, Harvard University, Pacific Community Ventures, The Rockefeller Foundation and The Global Impact Investing Network.

The report noted that 79% of impact investors were already targeting market rates of return, highlighting that impact investments can target "a range of returns from below-market to above-market returns", it all depends on the financial return requirements of the investors.

This simple yet powerful conclusion reflects the diverse interest in Investing-for-Impact from faith-based investors, pension funds, development finance institutions (DFIs), philanthropic foundations, venture capital investors and sovereign wealth funds, all with a role to play in addressing social inefficiencies such as unequal access in areas including energy, housing, healthcare, education, financial services and food and agriculture.

As an impact-focused fund manager seeking to deliver above-market returns and tangible social outcomes, Summit's approach to Investing-for-Impact involves:

- being deliberate about building intangible assets alongside tangible, financial ones;
- a clear commitment to "intentionality" by setting deliberate objectives focused on addressing social inefficiencies such as transformation, diversity and inclusion, improving access or affordability of products and services for the low-income population, climate, etc., with the same rigor as that applied to setting objectives for financial performance;
- maintaining a disciplined investment process to identify niches where a commercial business model can be "impact-enabled" to address structural social inefficiencies in a sustainable manner;
- applying a thematic, multi-disciplinary, hands-on approach to post-investment value and impact creation and reporting; and
- solving for the eventual liquidity event as part of the pre-investment process.

Over the past five years, Summit has applied these principles consistently, realising above market returns for pension fund members (including a distribution to paid-in-capital (DPI) more than 75%) while simultaneously delivering significant social impact in peri-urban, rural and township communities in South Africa.

Summit recently published the 2023 Impact, ESG & Sustainability Report for the Summit Private Equity Fund (available here), which showcases how Summit's investment in sectors such as financial services, tertiary education and training, healthcare, and ICT services has addressed structural undersupply, creating sustainable impact and delivering strong, risk-adjusted returns across market cycles.

Nine features to integrate into a private market impact investment strategy that targets an above market return

Drawing from our experience, we provide nine features that asset allocators and fund managers could consider and integrate into a private market impact investment strategy that aims to realise above market returns.

1. Develop a clear definition of the target population and the social inefficiencies that impact them.

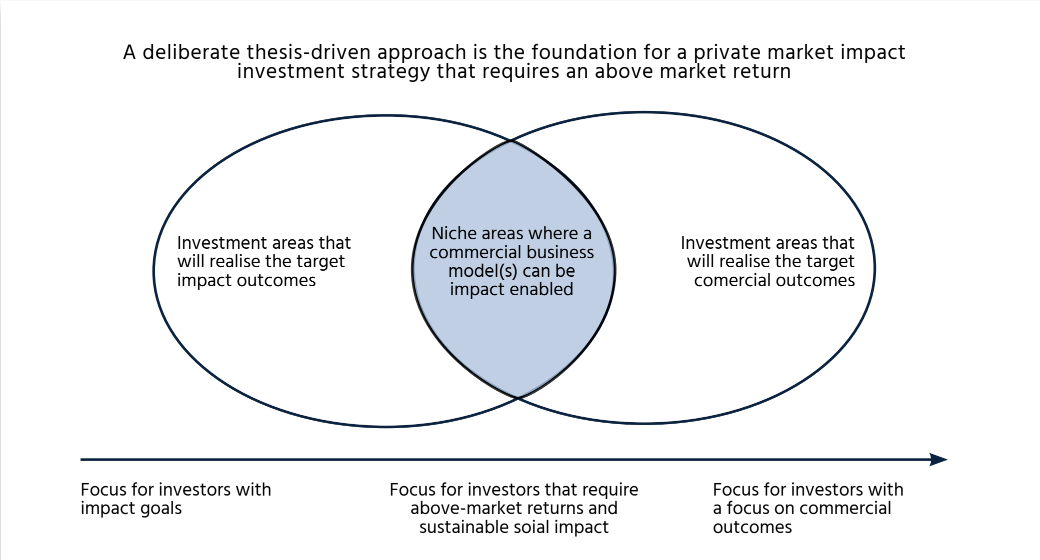
    - The target population could be based on race, ethnicity, gender, income group, Living Standard Measure (LSM) or location, etc.
    - Once the target population has been defined, the social inefficiencies or challenges that affect the target population can be identified. The target population and the social inefficiencies or challenges that impact them should be as detailed, specific and unambiguous as possible, and measurable.
    - Possible social challenges include but are not limited to (i) Economic Vulnerability due to a lack of savings, access to credit and the ability to manage financial risks; (ii) Health and Nutrition due to poor living conditions and limited access to healthcare; (iii) Limited access to quality education and training, which restricts opportunities for upward mobility and hampers employment prospects; (iv) Inadequate infrastructure, such as roads, transportation, and communication networks, which limits access to markets, services, and information; (v) Social exclusion / Discrimination / Lack of representation, which limits participation in economic and civic life, or access to resources and opportunities.

2. Clearly determine the desired social outcome(s), and where possible, align them to a recognised impact framework(s) for purposes of measurement and reporting.

    - The definition of the desired social outcome(s) should be as detailed, specific and unambiguous as possible.
    - Alignment with a recognised impact framework for measurement and reporting ensures the appropriate focus and accountability for the impact outcomes.
    - Relevant international impact frameworks include international impact frameworks include the Operating Principles for Impact Management (OPIM), Global Impact Investing Network (GIIN), Sustainability Accounting Standards Board (SASB), Global Reporting Initiative (GRI) and Principles for Responsible Investment (PRI). Relevant domestic impact frameworks include the National Development Plan 2030 and BBBEE Codes.

"THIS SIMPLE YET POWERFUL CONCLUSION REFLECTS THE DIVERSE INTEREST IN INVESTING-FOR-IMPACT FROM FAITH-BASED INVESTORS, PENSION FUNDS, DEVELOPMENT FINANCE INSTITUTIONS (DFIS), PHILANTHROPIC FOUNDATIONS, VENTURE CAPITAL INVESTORS AND SOVEREIGN WEALTH FUNDS, ALL WITH A ROLE TO PLAY IN ADDRESSING SOCIAL INEFFICIENCIES SUCH AS UNEQUAL ACCESS IN AREAS INCLUDING ENERGY, HOUSING, HEALTHCARE, EDUCATION, FINANCIAL SERVICES AND FOOD AND AGRICULTURE."

3. Identify niches within target industries or sectors that are best positioned for above-market financial returns and where a commercial business or business model can be "impact-enabled" to address the structural undersupply of products and services in a manner that will directly or indirectly achieve the desired social outcome(s).



4. Determine the key stakeholders and establish aligned partnerships with stakeholders with whom collaboration is required to achieve the desired social outcomes and above-market financial returns.
   - The universe of stakeholders and partnerships could include industry practitioners, local authorities, communities, and other impact-focused fund managers or investors.
5. Include ESG integration.
   - Using a recognised ESG framework, incorporate ESG criteria into investment decisions. This helps to identify opportunities with sustainable practices that are likely to deliver long-term financial returns alongside social impact.
6. Design an impact reporting framework and process, ensuring the regular measurement and reporting of the impact outcomes in the same rigor as applied to the measurement and reporting of financial performance.
7. Solve for the eventual liquidity event as part of the pre-investment process.
8. Adopt a multi-disciplinary approach to post-investment value and impact creation, including specific strategies to address sustainability and inclusion objectives as part of a commercial business model. Strategies to address sustainability and inclusion objectives include but are not limited to embracing innovation and technology (technology driven/enabled solutions) to enhance efficiency, scalability, affordability and accessibility of impact-orientated products and services.
9. Align accountability models for both the fund manager and key individuals within the investment team or portfolio investment to achieve the desired impact outcomes. This could include impact-linked incentives.

A case study on Custom Capital Finance

The Summit Private Equity Fund's (the "Fund") overarching objective is to deliver above-market returns and tangible social outcomes through investment in private equity opportunities that

(i) promote financial inclusion for previously disadvantaged individuals and SMMEs;

(ii) promote access to affordable education, training and learning for mostly previously disadvantaged individuals; and

(iii) increase access to affordable quality healthcare and specialist healthcare services predominantly in the township, rural and peri-urban areas of South Africa.

Since its inception, Summit has invested over R1.4 billion in the target sectors, realising the desired financial and social impact outcomes on behalf of pension members. One such investment, which illustrates our commitment to addressing social inefficiencies while simultaneously ensuring fair risk-adjusted returns for pension members is the investment the Fund made into Custom Capital Finance in 2022.

Custom Capital Finance assists Small, Micro and Medium Enterprises ("SMMEs"), who traditionally struggle to secure financing from banks and debt providers, by providing alternative financing products, specifically asset-backed Rental Finance and Invoice Discounting financing products.

This form of alternative finance is critical to SMMEs, who in turn play a crucial role in driving economic growth (contributing 34% of GDP) and job creation (SMMEs employ 50% to 60% of South Africa's workforce). A report by the SA SME Fund estimates that the SMME credit gap in South Africa is between R86 billion and R346 billion.

In line with its investment objectives, the Fund acquired a majority interest in Custom Capital Finance, in so doing providing an equity capital injection to enable Custom Capital Finance to meet the financing needs of even more SMMEs. In addition, Summit jointly arranged a R2 billion debt finance note programme for Custom Capital Finance with Rand Merchant Bank, further increasing Custom Capital Finance's ability to meet the structural need for access to finance by SMMEs. In 2023 alone, Custom Capital Finance provided finance to 2,583 SMMEs. Assuming 20% of each of these SMMEs employed one extra person, this would result in a minimum of 516 new jobs being created in 2023 through the Fund's investment.

The investment in Custom Capital Finance has delivered an above-market investment return for the Fund in addition to the tangible social impact, which addresses the structural need for access to finance by SMMEs.

As part of the post-investment value and impact creation plan that was agreed with Custom Capital Finance and other stakeholders, Summit will also support Custom Capital Finance to establish and have allocated capital (i) for a Rental Finance

516 NEW JOBS

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product explicitly supporting black-owned and run women's businesses; and (ii) for Invoice Discounting specifically in support of black-owned suppliers, who supply products and services to blue chip debtors and where this product will be actively promoted to the blue-chip debtors.

To read more about Custom Capital Finance and other Investments-for-Impact that Summit has made over the past five years, please refer to the Fund's 2023 Impact, Sustainability and ESG Report here.

SMMEs CONTRIBUTE 34% OF GDP

Alternative finance is critical to SMMEs, who in turn play a crucial role in driving economic growth and employ 50% to 60% of South Africa's workforce.

CONCLUSION

Pension fund trustees and managers have a fiduciary requirement to ensure fair risk-adjusted returns for current and future pensioners.

The ability of impact investors to deliver above-market financial returns while addressing social inefficiencies in a tangible and sustainable manner lies in their ability to apply a thematic, yet multi-disciplinary approach to building intangible assets alongside tangible, financial ones.

For fund managers or asset allocators establishing a private market impact investment strategy that targets an above-market financial return, we believe that the foundation of a successful impact investment program should incorporate all (or some) of the nine features outlined above.

R86 BILLION - R346 BILLION

A report by the SA SME Fund estimates that the SMME credit gap in South Africa is between R86 billion and R346 billion.