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Financial inclusion pops out as a full-fledged investment category

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For professional investors only

Impact funds provide a financial return to investors and they give shape to their intention to have a positive influence on society and the environment. Moreover, financial inclusion as topic within impact investing offers a measurable positive impact combined with an attractive risk/return profile.

Impact investors focus on products and services with the intention of delivering a social and/or sustainable impact. They therefore finance specific activities or company projects aimed at energy efficiency, sustainable farming, healthcare and financial inclusion. This approach is different to sustainable investment strategies, which excludes sectors or selects only companies with the best ESG score.

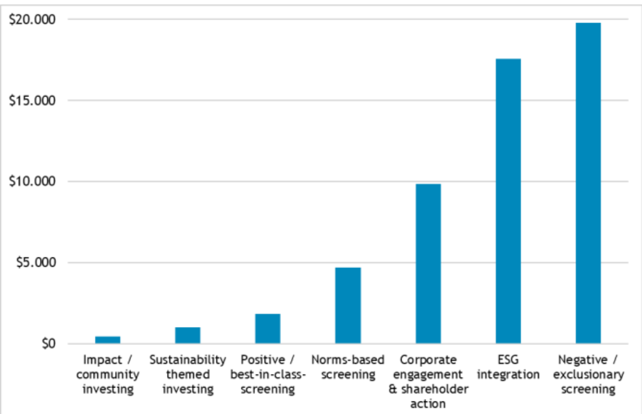
Financial inclusion is one of the most popular and one of the oldest themes in impact investing. These investments broaden access to financial services such as lending, payment transactions, saving and investing. There is a great deal of ground to be gained by financial inclusion, particularly in emerging markets. Not only does it improve the situation of businesses and people, but it also affects a country's entire economy.

AT THE FOREFRONT OF SUSTAINABLE INVESTING

Impact investing goes one step beyond other forms of sustainable investment in the sense that it aims to achieve a measurable positive societal impact. This should readily go hand in hand with a financial return, and it is closely aligned with the fiduciary obligation incumbent on both sustainable investors and the somewhat more traditional investors who have yet to take their first steps in ESG.

On sustainable investing as a whole, impact investing is still relatively small, but its growth in recent years has been impressive. At the beginning of 2018, $444 billion had been invested in impact strategies, an increase of 79 percent over the previous two years. In the same period, sustainable investing overall showed an increase of 34 percent. These figures are from the Global Sustainable Investment Alliance (GSIA), an international platform of the sustainable investment sector.

Various forms of socially responsible investment in AuM



Source: GSIA, from GSIR 2018. In US$ billions.

One year later, in 2019, the Global Impact Investing Network (GIIN) estimated the extent of the impact investment market at approximately $500 billion worldwide, a sign that the demand for this kind of investing continues to grow. According to figures from the PRI (Principles for Responsible Investment) Collaboration Platform, around $80 billion of that has since been invested in the impact theme of financial inclusion.

Theme allocation of impact investors

		Geographic focus		Asset class focus	
	Overall	DM-focused	EM-focused	Private-equity-focused	Private-debt-focused
Energy	15%	16%	13%	10%	10%
Microfinance	13%	1%	23%	7%	47%
Fin services (excl. microfinance)	11%	2%	22%	18%	9%
Food & ag	10%	8%	14%	13%	6%
WASH	7%	17%	0.7%	1%	0.5%
Housing	7%	13%	1%	8%	9%
Healthcare	6%	6%	5%	21%	3%
Forestry	5%	11%	0.4%	5%	0.3%
Infrastructure	4%	2%	7%	0.3%	0.7%
Education	4%	6%	2%	7%	5%
Manufacturing	2%	1%	3%	1%	1%
ICT	2%	3%	0.9%	3%	1%
Arts & culture	0.1%	0.3%	0.0%	0.0%	0.4%
Other	15%	13%	9%	6%	6%
Number of investors	259	114	112	78	62
Total AUM (USD millions)	130,708	47,337	57,229	15,945	22,789

Excluding outliers. 'Other' sectors include commercial real estate, the retail sector, community development, and multi-sector allocations.
Source: Annual Investor Survey GIIN

In the meantime, it seems that the availability of suitable impact investment projects doesn't match with the demand. Earlier, Dutch pension fund Zorg en Welzijn announced that it would not achieve its this year's objective of 20 billion euros in impact investments.

Measuring the social and sustainable effects of an investment also continues to be challenging given the lack of standardised norms and data. The investment industry has responded to this challenge: a number of collaborative alliances now focus on developing and fine-tuning parameters. Examples are PRI and GIIN through IRIS+, which provide not only databases but training programmes as well.

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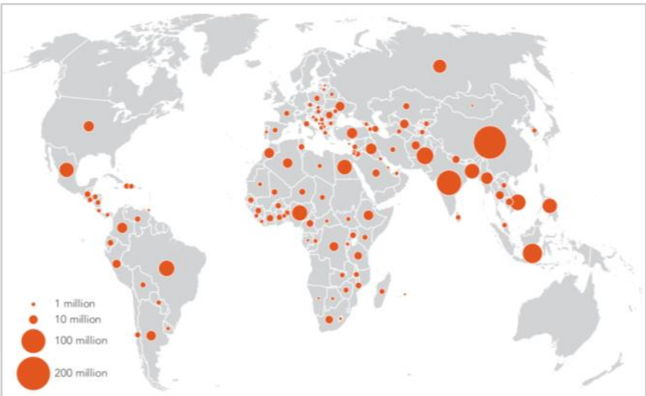
THE IMPACT

As to availability of and experience with data, the theme of financial inclusion has a head start given that microfinancing has been around for several decades. Microfinancing funds – and nowadays financial inclusion funds as well – provide capital to financial institutions in developing countries. These local organisations use the funding to issue microloans mainly to owners of small businesses.

The social effect of these early impact investments has been considerable. One of the most interesting examples of this is that, according to the World Bank, nearly one-third of the adult population worldwide has no bank account (as a means of creating impact). Half of this group is accounted for by seven countries: Bangladesh, China, India, Indonesia, Mexico, Nigeria and Pakistan.

Technology, such as banking via mobile phone, can play an important role in interacting with this group, as many people without a bank account do have a mobile, according to a report by the McKinsey Global Institute over 'digital finance'. The potential impact is huge. The report concludes that, in the space of ten years, digital finance will be able to add at least 3700 billion dollars to the national income of developing countries. It is essential that the sector itself develops and monitors responsible standards.

Number of people without a bank account, but with a mobile phone



Note: Data are not displayed for economies where the share of adults without an account is 5 percent or less.
Source: World Bank, Global Findex database; Gallup World Poll 2017

The report describes an example of a rapidly growing provider of mobile finance in Kenya, M-Pesa. An impact study showed that this provider achieved a market share of 70% among adults in a very short space of time, thus giving 200,000 households a route out of poverty. The economic situation of women showed particular improvement. Women are overrepresented in groups without access to financial services.

The theme of financial inclusion is also reflected in as many as eight of the seventeen Sustainable Development Goals (SDGs) launched by the United Nations in 2015. Many impact investors use these UN goals as a scale to measure the non-financial effects of investments.

According to the United Nations Secretary Generals Special Advocate for Inclusive Finance for Development (UNSGSA), financial inclusion is reflected in a range of these goals, for example fighting poverty (SDG 1), promoting health (SDG 3), gender equality (SDG 5), economic growth and jobs (SDG 8) and tackling income inequality (SDG 10).

Financial inclusion intertwined in SDGs

For investors, this means that anyone who invests in financial inclusion thereby contributes to eight UN sustainable development goals at the same time.

FINANCIAL RETURNS

There is great potential for social return on financial inclusion investments. But the financial return is always the starting point.

Historical returns from impact investment as a category are not always easy to find. What is more, there are differences between individual impact themes, and the asset category chosen (private debt, private equity, listed shares and bonds) influences the return/risk profile as well. However, in the coming years, more and more data will become available on returns per theme and per investment category.

Investors can already find a sound basis for financial inclusion in the track records of microfinancing funds, the largest sub-segment in this theme. The average performance of funds that invest in unlisted fixed-interest securities is shown by the SMX-MIV Debt Index. This benchmark tracks a basket of the biggest microfinancing funds active in private debt. Since 2008, the index has achieved an average annual return of around 3 percent (in dollars). In today's search for yield, that is something to take into account. In view of the low risk – the number of defaults is low – this provides an attractive risk/return profile for investors.

Nevertheless, Dutch pension funds seem reticent. Since early 2015, De Nederlandsche Bank (DNB) has included microfinancing as a separate investment category in its quarterly reports on the asset mix of Dutch pension funds. The totals are small but consistent, with 237 million euros in the first survey and 275 million euros at the end of 2019. We note, however, that DNB's reports do not include a separate category for impact investment or financial inclusion, which means that the actual amount of assets in impact investments is many times greater.

LIQUIDITY AND EXPERTISE

Possible reasons for this reticence may be the limited liquidity of microfinancing investments via private debt and the awareness that there is insufficient insight into the underlying individual projects. Furthermore, a good risk assessment requires specific expertise.

The illiquidity of the positions in microfinancing funds via private debt is certainly a factor that investors must bear in mind when considering non-listed investments. These investments usually have a ‘buy-and-hold’ strategy, a long maturity and are usually structured as less liquid private loans. What could help here is developing a secondary market for the loans. On the other hand, the lack of a listing also offers advantages, such as an illiquidity premium and less price volatility. The segment also has a low correlation with other investment categories. Between 2004 and 2017, the US firm Athena Capital Advisors calculated that the SMX index had no correlation, or a negative one, with nearly every other asset category.

Investors can draw on the knowledge and experience of specialised parties to gain an insight into underlying individual investment projects and the corresponding risks. Microfinancing funds or impact funds issue periodic reports on risk and returns as well as on the impacts of investments on society and the environment. This is very important to institutional investors such as insurers and pension funds, as they are in turn accountable to their stakeholders.

The ‘Impact Investing Market Map’ provides a number of useful performance indicators as well as behavioural and reporting guidelines to each impact theme. As regards financial inclusion, these include the number of clients of a local microfinancing organisation, employment opportunity in companies that have obtained credit and the increase in the related number of jobs.

CONCLUSION

Impact investing is a worthy alternative for all investors in the search for yield and in the ambition to make investments more sustainable. Financial inclusion (and microfinancing) is an excellent theme within impact investing. Via microfinancing, impact investing has already built up quite a track record, with both financial and social returns. Finally, the theme is future-oriented, running throughout many of the sustainable development goals of the United Nations (eight out of seventeen).

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