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Trade-offs in decision making by impact investors between socio-environmental return and financial return

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Abstract

Impact Investing is an alternative source of funding for socio-environmental impact optimising organisations. The legitimacy of this investment approach has been questioned however, as the model combines two competing institutional logics. The impact investor faces the logic of socio-environmental impact and the profit logic, which have traditionally been thought of as being on opposite ends of the spectrum. Combining multiple logics is confusing and can ultimately handicap the firm, however this can be resolved by specifying the trade-offs among the various dimensions. Research on Impact Investing in the past few years focused on the performance of Impact Investing funds in comparison to conventional funds, but could not conclusively prove if there is a cost to Impact Investing. For this reason there is not a full understanding of the trade-offs, if any, of Impact Investing. The objective of this study is to demystify the trade-offs inherent in Impact Investing, in order to support the legitimacy of the investment strategy as an alternative form of financing.

The study was performed as a qualitative research, using 15 semi-structured, in-depth interviews with investment professionals and experts, who had been practicing for at least two years. The collected data were analysed using inductive content and frequency analysis techniques, which enabled the researcher to extract and extrapolate the recurring themes and develop a practical framework for effective management of an Impact Investing asset portfolio.

The results of this research show that the question of trade-offs depends on the framing, as there are instances where the trade-offs are distinct, however high impact and high returns can be achieved without compromise. There is no denying the immensurable risks involved in Impact Investing, some are as seen in conventional capital markets, yet some are inherent not only in the impact approach, but also in other variants of the strategic positioning of the investment firm involved. The risks can be mitigated by integrating impact into the business model and aligning values throughout the Impact Investing value chain.

Keywords

Impact Investing, trade-offs, paradoxes, hybrid organisations.

Declaration

I declare that this research project is my own work. It is submitted in partial fulfilment of the requirements for the degree of Master of Business Administration at the Gordon Institute of Business Science, University of Pretoria. It has not been submitted before for any degree or examination in any other University. I further declare that I have obtained the necessary authorisation and consent to carry out this research.

Eunivicia Matlhogonolo Mogapi

Date

Dedication

This research report is dedicate to my late grandparents, Taolo and Khumonyane, robala ka kagiso tholo, tlhapi. Robala ka kagiso maseru, setouto sa mokalaka. Thank you for raising me with so much love and instilling 'botho', love and respect for all in me. Kealeboga.

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To God, who is first in everything, thank you for your provision, wisdom, strength and energy that enabled me to successfully complete this MBA. Glory to you now and always.

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Chapter 1: Introduction to the research

1.1 Introduction

The shifting narrative of the purpose of the firm has led to a finance evolution in the form of an investment strategy that closes the gap between private wealth and socio-environmental ills. This finance reform has various terminologies: Ethical Investing, Social Responsible Investing and Sustainable Investing, however it was called Impact Investing by the Rockefeller Foundation in 2007 (Hochstadter & Scheck, 2014). Impact Investing is not only seen as doing good, but it can also be added into an investment decision making framework as a fourth layer after liquidity, return and security, as it signifies the sustainability of the investment and supports a more sustainable economic system (Schmidt & Weistroffer, 2010). It is said to harness entrepreneurship, innovation and capital to power social improvement (Social Impact Investment Taskforce, 2014).

The narrative that gave birth to the impact investor is that organisations are not independent of the environment, they are in fact borne of the prevailing social context (Battilana & Lee, 2014), and therefore investment should be geared towards business activities that drive socio-environmental sustainability. Abigail Noble of the World Economic Forum was quoted as saying, “The millennials will inherit some \$40 trillion, 36% of them think that the primary purpose of business should be to improve society and about half of millennials think that businesses can do more around resource scarcity and inequality” (Fox, 2014).

In their 2015 report, McKinsey & Company stated that government debt increased by 75% in advanced economies since 2007 (Dobbs, Lund, Woetzel, & Mutafchieva, 2015), and it continues to grow as governments strive to provide their growing populations with social services. Jackson (2013) agreed, commenting that government and philanthropic grants are insufficient to solve the problems faced by the bottom billion. Cohen and Sahlman (2013) noted that governments are straining to fund their commitments to solving social issues as they are limited by the old way of doing things, and that the social entrepreneur, like government, is struggling to fund impactful projects. Cohen and Sahlman also argued that the traditional forms of funding, i.e. donations and grants, are stifling innovation in social enterprises, and therefore private investments should be directed at businesses with a positive socio-environmental impact.

Impact Investing has seen substantial growth over the past few years, with JP Morgan in collaboration with The Global Impact Investing Network (GIIN) estimating the market at \$60 billion at the end of 2014 (Patton, 2015). The size of the market differs depending on how Impact Investing is defined however, as there are various investment strategies. This is a

concern as it is impacting the legitimacy of the investment strategy, and therefore inhibiting the growth of the sector (Hochstadter & Scheck, 2014).

1.2 Research purpose

Jensen (2002) argued that having multiple objectives is confusing and can ultimately handicap a firm, however this can be resolved by specifying the trade-offs among the various dimensions. Peters (2012) proposed that in addressing paradoxes in decision making, management should expect and prepare to be challenged by paradoxical problems, and therefore it is important to identify and understand them. The purpose of this research is to demystify the trade-offs in Impact Investing in order to support the legitimacy of the field and contribute to the theoretical understanding of the paradox of Impact Investing.

The growing funds managed under Impact Investing strategies are growing and industry is awash with the construction of Environmental, Social and Governance (ESG) themed portfolios. The Public Investment Corporation, the largest fund manager in Africa managing money for Government Employees Pension (GEP) fund, distributes funds to different portfolio managers and insists that portfolio managers focus not only on returns but also on social developmental factors. The investment strategy is relevant in South Africa due to the pressing need in the country for alternative forms of funding for development projects, with the decreasing education standards resulting in a high rate of unemployment in youth (aged 18 to 35) and large inequality gaps.

1.3 Research problem

Impact Investing is viewed by some as being transformational and capable of mobilising entrepreneurship, innovation and capital to solve some of society's most challenging problems (Burand, 2014). Others view Impact Investing as an economic mechanism for supervising corporate behaviour and securing people's social and economic welfare into the future (Radu & Funaru, 2011). Growth in Impact Investing is, however, affected by the assumption that there is a cost to adding impact factors to investment decisions, thereby eroding shareholder value (Snider, 2015). The universe of assets for Impact Investing is smaller than the conventional efficient frontier-line as per the Capital Asset Pricing Model (CAPM) portfolio, reducing the impact of diversification and therefore making the investment strategy risky (Bilbao-Terol, Arenas-Parra, & Canal-Fenandez, 2012). Furthermore, there is a perception that impact portfolios underperform conventional portfolios, as the constraints caused by impact factors increase management costs (Benson & Humphrey, 2008). This is despite the fact that numerous empirical studies show insignificant differences in the performance of impact funds against conventional funds. A shortcoming of the various empirical studies on Impact Investing

is the limitation in application to investors focussed on non-listed investments, as these empirical studies are based on available market information of listed companies.

The question of the fiduciary duties of management (and in this case asset managers) and the purpose of the firm is central to the debate of the legitimacy of the investment strategy (Brandstetter & Lehner, 2015). This is not a new debate; The New York Times featured an article by Milton Friedman in 1970, in which he opined that the 'corporation' has one purpose, which is to make profits. This argument is centred on the premise that when management focuses on profit maximisation, this will automatically enhance social welfare as there will be more tax derived by the revenue services (Hallerbach, Ning, Soppe, & Spronk, 2004). Notably, the economic framework of the efficient use of resources supports that social ills should be addressed by governments as they are adequately equipped to address them, while business focuses on value maximisation for shareholders.

The argument against the profit maximisation view, stated Hallerbach *et al.* (2004), is that organisations can only maximise shareholder value by focusing on the variety of stakeholders, for example happy employees will drive productivity, whereas happy customers will remain loyal. Santos, Pache and Birkholz (2015) agreed, stating that addressing social issues is good business in that social-oriented products may increase sales and pricing power, sustainability initiatives often increase the efficiency of the value chain, CSR projects can create goodwill in the communities in which companies operate, and addressing the needs of low-income populations may open up profitable new markets. Internally, proponents argue that sound social and environmental performance signals high managerial quality, which translates into favourable financial performance (Radu & Funaru, 2011). Hayes (2005) referenced popular business ethics texts, which attribute good financial performance to strong commitment by organisations to ethical practices when compared to firms with low commitment to ethical practices. Other scholars (Copp, Kremmer & Roca, 2010; King & Gish, 2015) have argued that the issue against consideration of impact in decision making is with the law and that the legal frameworks around fiduciary duties need to be adapted to the growing movement in corporate social responsibility and sustainable investing.

A question remains regarding Impact Investing: how can the non-financial factors be incorporated into portfolio construction? Social goals are difficult to measure due to individuality and a lack of objective criteria, which poses an obstacle to investors selecting among different investment funds (Hayes, 2005). Current risk assessment tools used are the same measures used by conventional asset managers (Brandstetter & Lehner, 2015). There is a new concept emerging in the field, distinguishing investors into impact-first investors who are interested in providing funding for organisations that are not able to generate market returns, and more financially focused investors (Brandstetter & Lehner, 2015). The legitimacy

of Impact Investing, where the field forms an alternative source of financing for socially and environmentally responsible enterprises, rests on the market understanding of the construct.

1.4 Research objectives

The literature highlights that there are various investment strategies that incorporate non-financial factors (Hochstadter & Scheck, 2014). There is also developing literature on categorising people investing in impact funds into values-driven and profit-driven investors (Derwall, Koedijk, & Horst, 2011; Brandstetter & Lehner, 2015). Glac's (2009) experimental study on decision frames and trade-off options proved insightful, however the result was significantly limited by the use of university students with no investment experience. Therefore, given the gap in the literature on how the Impact Investing assets are selected, the first objective of this study is to understand how the investment portfolio for Impact Investing is constructed. Secondly, this study seeks to gain insight into the trade-offs (or risks) of Impact Investing.

The literature on competing institutional logics and paradoxes points to sustainability achieved through a balance of the opposing forces over time, however it does not address how this can be practically achieved. Therefore, the third objective of this study is to establish how this equilibrium can be practically achieved in Impact Investing.

The definition of Impact Investing by the GIIN requires the non-financial factors to be measurable (Hochstadter & Scheck, 2014). Glac (2009) pointed to Impact Investors gaining non-financial utility on their investment, however there is no consensus regarding how the non-financial factors should be measured. For this reason, the fourth objective of this study is to establish what the performance measurement metrics are for non-financial factors.

Chapter 2: Literature review

The literature reviewed revealed that the construct of Impact Investing hinges on the institutional, paradox and stakeholder theories and on hybrid organisations. The literature also revealed that the central themes of investment decision making are portfolio construction of an impact fund and financial performance. The critical aspect of Impact Investing, which is the measurement of the non-financial factors, was also discussed in the literature, thus this literature review is structured under the following headings:

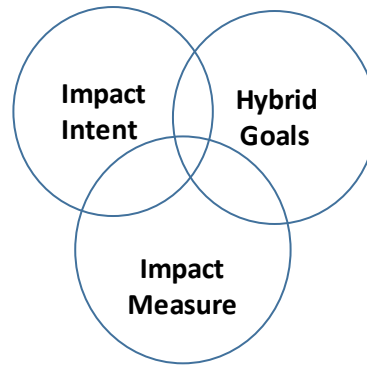
- Background of Impact Investing
- Theoretical underpinnings
- Impact funds
- Financial performance
- Measurement of non-financial factors

2.1 Background of Impact Investing

2.1.1 Defining Impact Investing

The Global Impact Investing Network (GIIN) defined impact investments as “Investments made into companies, organizations, and funds with the intention to generate social and environmental impact alongside a financial return” (Global Impact Investing Network, 2016). The term Impact Investing was first introduced in a conference hosted by the Rockefeller Foundation in 2007, with the objective of legitimising the investment strategy in order to increase investment flows into the field (Hochstadter & Scheck, 2014). Even with the introduction of the term, ambiguity still exists in the market as to what Impact Investing is. Various other terminologies are used interchangeably (ethical investing, socially responsible investing, sustainable investing) and sometimes incorrectly in reference to investment strategies that incorporate non-financial factors (Hochstadter & Scheck, 2014). Even with a lot of different terms, what is true of Impact Investing is that it incorporates the following elements: clear intent of generating social or environmental impact, hybrid goals, and measurable non-financial factors (Hochstadter & Scheck, 2014). The below diagram derived from Jackson’s (2013) article on the theory of change shows the three elements of Impact Investing as per the GIIN definition:

Figure 1: Elements of Impact Investing



Source: Jackson (2013)

2.1.2 Motives for investing for impact

Impact Investing is driven by changing regulations on the one hand, and by changing customers' or investors' demands to invest in socially responsible firms on the other (Peylo, 2012). As to why the Impact Investing market is growing exponentially, Haigh and Guthrie (2010) asserted that responsible investing markets are formed for various reasons, including market opportunism, founding legacies and pressure from customers. Impact investors are motivated by varying personal, ethical and social convictions (Renneboog, Horst, & Zhang, 2008), however this is not a charitable donation as impact investors have financial return expectations (Lewis, 2001). Some investors view investing as an extension of their lifestyle or identity (Lewis, 2001). Webley, Lewis and Mackenzie's (2001) study revealed that enthusiasm for investing responsibly dropped when financial returns were poor, yet Benson and Humphrey's (2008) research showed that, unlike conventional funds, socially responsible investing (SRI) funds flows are less sensitive to past returns. Renneboog, Horst and Zhang (2008) noted that impact investors are less likely to move investments from one fund to another, and are more inclined to stay with funds than conventional investors. Notably, the egoist impact investor is said to invest for impact as a profit maximisation strategy, as impact assets are said to provide enhanced returns (Viviers & Eccles, 2012).

2.1.3 Investor profile

Beal, Goyen and Phillips (2005) listed three types of investors with varying motives: the rational investors look to benefit from sustainability; the consumption investors invest ethically as an extension of their lifestyle; and the investing investors act out of personal concern for society and the environment. Derwall, Koedijk and Horst (2011) categorised impact investors into two groups: the values-driven approach in which social and personal values are dominant; and the profit-seeking approach where profit maximisation is dominant. They found that the

values-driven approach is more pervasive. Lewis' (2001) research compared a group of responsible investors to conventional investors, and showed that some responsible investors had investments in conventional funds for diversification purposes, concluding that not all investors in SRI funds are the same.

Snider (2015) stated that even though institutional assets are much larger than those of individual investors, individual investors are driving the demand for Impact Investing. Furthermore, she stated that investors are also changing how they approach investing, with nearly six in ten investors stating that they now consider the social and environmental impact of the companies they invest in to be an important part of their investment decision-making process. The numbers are even higher for millennial investors as 85% of them consider social, political or environmental impact to be important (Snider, 2015). The profile of impact investors in Africa includes asset management funds, Development Finance Institutions (DFI) and donors, private equity managers, institutional investors and foundations (UNDP, 2015). In South Africa, banks and pension funds (estimated to hold R3.8 trillion in assets) are the biggest asset holders (GIIN, 2016). This is consistent with the global landscape, as the 2016 GIIN Annual Survey reported that pension funds and the insurance industry are the largest owners of capital in Impact Investing

2.1.4 Impact Investing in South Africa

Heese (2005) reviewed the global responsible investing trends and their possible application to South Africa, and asserted that the sanctions on South Africa in the 1980s were a major driver globally for Impact Investing, even though the country was slow to catch-up. The 2016 GIIN Annual Survey identified that the two biggest challenges for industry growth, which were the same for the preceding three years, were the lack of appropriate capital across the risk/return spectrum, especially in seed stage investing, and the lack of high-quality investment opportunities (fund or direct) with track records..

In the 2015 African Investing for Impact Barometer, the Bertha Centre for Innovation and Entrepreneurship at the University of Cape Town estimated that the current assets managed in some form of ESG integration or Impact Investing were \$6 billion. The Centre categorises asset managers and private equity (or venture capital) funds based on the following investment strategies (Giamporcaro & Dhlamini, 2016):

- ESG integration (71% of total assets). ESG factors are integrated into research, investment analysis and performance measurement.
- Investor engagement (68% of total assets). Active engagement of investors in shaping company behaviour.

- Screening (29% of total assets). An investment strategy in which investments are positively or negatively screened based on ESG factors.
- Thematic investing (3% of total assets). This strategy is not explicitly trying to achieve environmental or social impact, however its investments are targeted at environmental sustainability and inclusive socio-economic development themes.
- Impact Investing (1% of total assets). An investment strategy intended to generate positive environmental and social impact alongside a financial return.

Ernest & Young released a research report in which it's surveyed respondents overwhelmingly indicated that they have knowledge of, and/or they subscribe to, the Code for Responsible Investing in South Africa issued by the Institute of Directors Southern Africa and the United Nations' Principles of Responsible Investing (PRI). This indicates that South African institutional investors are aware of responsible investing (Van der Ahee & Schulschenk, 2013). The ecosystem is also developing, with research houses like the Bertha Centre and Greater Capital, an Impact Investing strategic consulting company based in Cape Town (Greater Capital, 2016), creating an industry body called the South African Impact Investing Network (SAIIN). SAIIN holds an annual conference with the objectives of raising awareness, assisting impact investors with strategy development, and developing networks (SAIIN, 2016). Another notable actor in the ecosystem is Impact Amplifier, a consulting vehicle that provides investment readiness and acceleration services to impact businesses (Impact Amplifier, 2016).

2.1.4.1 Regulation around Impact Investing

The direct involvement of regulators in driving Impact Investing was noted in New Zealand and Australia, requiring standardised reporting for all investments with ESG themes or responsible investment funds to enable comparisons and make the investment decision making process easier for investors (Haigh & Guthrie, 2010). The United Kingdom instituted mandatory reporting, to the extent that the pension funds consider social, ethical and environmental impact in investment decisions, while several other countries in Europe instituted reporting requirements. These initiatives resulted in a positive impact on Impact Investing (Renneboog, Horst, & Zhang, 2008). The G8 taskforce noted that governments can play an important role in catalysing the growth of impact entrepreneurs by creating a permissive legal environment (Social Impact Investment Taskforce, 2014).

The South African laws and regulations play a big role in driving sustainability in the country (Ndhlovu, 2011). One of the ways the government used regulation to address social ills was by creating the Broad-Based Black Economic Empowerment (B-BBEE) Act to address the disparities in income and wealth distribution caused by the apartheid regime. The Act stipulates the measures that companies need to take in order to achieve the transformation

levels determined to be adequate. The elements considered include black equity ownership, black management control, employment equity, skills development, preferential procurement and enterprise development (Government Gazette, 2013). Furthermore, the 2008 revised Companies' Act requires public interest companies to appoint Social and Ethics Committees that will monitor the companies' contributions to social and economic development, good corporate citizenship, the environment, consumer relationships, labour and employment, health and public safety (Government Gazette, 2009) to support the cause of advancing social and environmental transformation by the business fraternity.

To incentivise impact investments, the government also used tax legislation by prescribing in Section 12J of the Income Tax Act provisions that allow investors in registered venture capital companies deductions of expenditures incurred in acquiring shares, provided that the companies are not involved in impermissible trade (gambling, liquor, tobacco, arms or ammunition, etc.) (Government Gazette , 2015). This provision was welcomed by the private equity industry body, the South African Venture Capital and Private Equity Association (SAVCA) (SAVCA, 2015). The Pension Fund Act, meanwhile, regulates the asset allocation of pension funds in Regulation 28, which was recently amended by increasing the allocation to alternative assets, a category which most impact investments would fall under, from 5% to 10% (GIIN, 2016). Other laws exist to foster the fair and ethical treatment of employees, customers and communities, drawing attention to good governance practices and making asset selection based on sustainability easy for impact investors.

To support government efforts, the King Code on corporate governance calls for Integrated Reporting, which forces companies not only to report financial information, but to report on sustainability issues of social, economic and environmental impact (King Committee, 2009). Industry codes, such as the Institute of Directors' Code for Responsible Investing in South Africa (CRISA), which provides guidance to institutional investors on investment decision making such that they promote sound governance (Institute of Directors, 2011), are also effective in drawing-in investments. The Johannesburg Stock Exchange (JSE) has also played a role in fostering social responsibility by compiling a Social Responsibility Index, which could assist impact investors in developing frameworks for selecting companies to invest in (Johannesburg Stock Exchnage, 2014). The Financial Services Charter, which came into effect in 2004, was voluntarily developed by the sector and aimed to drive investments into targeted development sectors of the economy (Financial Service Sector Charter Council, 2016). The Charter is a critical driver of impact investments, and is complementary to the B-BBEE Act.

2.2 Theoretical underpinnings of Impact Investing

2.2.1 Institutional logics

Institutional logics, which are both material and symbolic, are defined as socially constructed, historical patterns of material practices, assumptions, values, beliefs, and rules, by which individuals produce and reproduce their material subsistence, organise time and space, and provide meaning to their social reality (Thornton & Ocasio, 1999). Institutional logics provide guidelines on how to interpret and function in social situations, and organisations comply in order to gain endorsements from important referent audiences (Greenwood, Raynard, Kodeih, Micelotta, & Lounsbury, 2011). Institutional logics are also cultural materials through which organisations are formed, allowing for public identification and legitimacy (Battilana & Lee, 2014). Organisations face institutional complexities whenever they confront incompatible prescriptions from multiple institutional logics (Greenwood et al., 2011). King and Gish (2015) stated that the logic of social justice and environmental social change emphasises the redistribution of wealth, the internalisation of externalities, and other ideals that potentially threaten business profits, whereas the logic of capital accumulation emphasises profits. The combination of these competing logics could question the legitimacy of Impact Investing and may hinder its growth.

Early research on the competition between the social and profit logics show that the profit logic often dominated (King & Gish, 2015). Based on their research, Battilana and Dorado (2010) suggested that an organisation with competing logics needs to develop a common organisational identity that strikes a balance between them. Pache and Santos (2013) supported this view by suggesting that organisations embedded in these competing institutional logics need to combine elements of each by selectively coupling intact demands imposed by each logic, instead of decoupling or compromising as suggested by early research. King and Gish (2015) stated that most practitioners of SRI choose to operate at the intersection of the competing logics, even though the task of incorporating both logics into a coherent set of ideas and practices is challenging. Operating with this tension of the competing logics has led to innovations in how to think about and perform responsible investing (King & Gish, 2015).

2.2.2 Stakeholder Theory

The competing logics of profit maximisation and ESG investment in Impact Investing is synonymous with the old debate on the purpose of the firm (Margolis & Walsh, 2003), which neoclassic economists have argued is to maximise profits (Jensen, 2002; Margolis & Walsh, 2003). Viviers and Eccles (2012), in their review of research performed on social responsible

investing, found that the biggest challenge for the field was the fiduciary duty concept, which requires management to focus on the interests of the company's owners only, ignoring the sustainability of the environment the company is operating in. Neoclassic economists believe that the free market system has a built-in corrective mechanism, which will induce market discipline on daily business operations (Ndhlovu, 2011).

It is fortunate that Friedman's 1970 opinion has been debated, resulting in the formulation of other academic views on the purpose of the firm. Margolis and Walsh (2003) stated that the neoclassical view of the firm challenged the legitimacy and value of corporate responses to social ills. Jensen (2002) commented that if the firm's focus is on maximising total market value, which has a multi-lens view, then this objective will resolve the trade-off problem. Mitchell, Weaver, Agle, Bailey and Carlson (2016) concurred by stating that corporations should be managed for a multiplicity of sometimes conflicting stakeholders' interests. Supporting this view, Stakeholder Theory reasons that all persons or groups with legitimate interests participating in an enterprise do so to obtain benefits, and that there is no *prima facie* priority of one set of interests and benefits over another (Donaldson & Preston, 1995). This was acknowledged by Vermeir, Van De Velde and Corten (2005), when they argued that an integration of the interests of all stakeholders could create shareholder value by reducing non-financial risk and creating long-term growth opportunities for a company, a view also held by Peylo (2012).

Similarly, Klettner, Clarke and Boersma (2014) stated that companies need to balance the profit logic, and put governance structures and processes in place for corporate social responsibility to account for all stakeholders' interests in decision-making. Companies responding positively to stakeholder theory by integrating it into their cognitive frames should be strategically positioned to take advantage of funding available from Impact Investors. In building the social logic in institutional fields, Jones (1999) thought that to be able to execute this decision makers must possess values consistent with social responsibility and they must apply them in decision making. Pache and Santos (2013) and Battilana and Dorado (2010) agreed that human capital resources are critical in achieving a balance of the profit logic and social logic, and thereby create shared value.

2.2.3 Paradox Theory

The analyses of the tension between the profit maximising view and impact optimising suggest that it is a paradox and not a dilemma (Pache & Santos, 2013; Battilana & Dorado, 2010). Smith and Lewis (2011) defined a paradox as being contradictory yet interrelated elements that exist simultaneously and persist over time, whereas a dilemma is defined by Luscher and Lewis (2008) as mutually exclusive elements which require opposing solutions. Smith and

Lewis (2011) categorised paradoxes that stem from the plurality of stakeholders and result in competing strategies and goals as performing paradoxes, as tensions surface between the differing and often conflicting demands of varied internal and external stakeholders. A paradoxical lens thus needs to be adopted when addressing the issue of trade-offs in decision making of impact investors. Furthermore, categorically Impact Investing is a performing paradox per Smith and Lewis' (2011) definition.

In responding to managing paradoxes, Luscher and Lewis (2008) quoted Charles Handy's (1994) book, *The age of paradox*, when he likened it to riding a seesaw: "Living with paradox is like riding a seesaw. If you know how the process works, and if the person at the other end also knows, then the ride can be exhilarating. If, however, your opposite number does not understand, or wilfully upsets the pattern, you can receive a very uncomfortable and unexpected shock". This dynamic, integrated view of managing paradoxes is widely supported (Serretta, Bendixen & Sutherland, 2009; Smith & Lewis, 2011; Pache & Santos, 2013; Battilana & Lee, 2014; Naidoo & Sutherland, 2016). Paradoxes, argued Luscher and Lewis (2008), need to be managed by achieving equilibrium of the negative pulling forces over time. Battilana and Dorado (2010) supported this view by stating that a balance needs to be achieved between the elements of competing logics, however they emphasised that a common identity shaped by the interlinked frame needs to be achieved. Emphasis should also be placed on leaders in maintaining equilibrium over time (Luscher & Lewis, 2008). Furthermore, centred on Handy's (1994) analogy is an understanding by all institutional players of the common purpose.

2.2.4 Impact Investing is a hybrid

The hybrid goals concept (financial and social returns) is not new and originated in religious convictions (Renneboog, Horst, & Zhang, 2008). Battilana and Dorado (2010) defined a hybrid organisation as one that combines different institutional logics. These organisations, argued Brandsen and Karré (2011), stand at the crossroads of market, state and civil society. Hybrids are, by their very nature, arenas of contradiction (Pache & Santos, 2013), and naturally present a conflict of institutional logics (King & Gish, 2015). Hybrid organisations, according to Jay (2013), must contend with competing external demands and internal identities, resulting in excessive change which characterises the life of the hybrid organisations. This view supports the argument that a hybrid organisation is a naturally ambidextrous organisation as it has multiple focus areas. Critics of hybrid organisations warn that they are inherently unstable and are likely to have detrimental effects on service quality, yet Brandsen and Karré (2011) argued that these claims are theoretical or based on single case studies. In contrast, Battilana and Lee (2014) stated that such hybrids are a locus of disorder, and potentially of

creativity. The arguments show that an Impact Investing asset portfolio, as an institution, is a hybrid organisation.

2.2.5 Managing institutional demands

The identification of Impact Investing as a hybrid organisation does not provide insight into how they should respond to the inherent competing institutional logics. Hybrid organisations face both internal and external pressures (Battilana & Dorado, 2010), and it is important to understand which elements of the logics they enact as there are key linkages between institutional logics and intra-organisational processes (Pache & Santos, 2013), as well as between the organisation and its operating environment (institutional field) (Oliver, 1991). Pache and Santos (2010) noted that not all organisations face conflicting institutional demands in a given field in a similar way, and this will also be impacted depending on how an organisation interprets internal and external pressures. Battilana and Dorado (2010) studied two microfinance institutions in an attempt to ascertain how a sustainable hybrid organisation can be built, and came to the conclusion that it can be developed by creating a common organisational identity which is fostered by a combination of hiring practices and internal socialising. The below is a review of the models and frameworks proposed by different scholars.

2.2.5.1 *Strategic responses*

Oliver (1991) developed a framework for how organisations should respond to external pressures varying in active organisational resistance, on the basis of five types of strategies: (i) acquiescence is habitual following, imitating or complying with institutional pressures; (ii) compromise is an attempt to balance the institutional demands by pacifying or negotiating with stakeholders; (iii) avoidance refers to concealing nonconformity like engaging in window dressing or green washing; (iv) defiance is dismissing, attacking or challenging the sources of institutional pressures; and (v) manipulation is the most active of the strategies and refers to purposefully and opportunistically attempting to co-operate, influence, or control institutional pressures.

The below diagram depicts Oliver's (1991) framework, in which there are five antecedent external pressures which determine how an organisation should respond: (i) cause antecedent refers to why the organisation is being pressured; (ii) constituents refer to who is exerting the pressure; (ii) content determines what is being asked of the organisation; (iv) control looks at how or by what means the pressure is being exerted; and (v) context refers to the environmental context within which the pressure is exerted.

Figure 2: Institutional antecedents and predicted strategic responses

Predictive Factor	Strategic Response				
	Acquiesce	Compromise	Avoid	Defy	Manipulate
Cause					
Legitimacy	High	Low	Low	Low	Low
Efficiency	High	Low	Low	Low	Low
Constituents					
Multiplicity	Low	High	High	High	High
Dependence	High	High	Moderate	Low	Low
Content					
Consistency	High	Moderate	Moderate	Low	Low
Constraint	Low	Moderate	High	High	High
Control					
Coercion	High	Moderate	Moderate	Low	Low
Diffusion	High	High	Moderate	Low	Low
Context					
Uncertainty	High	High	High	Low	Low
Interconnectedness	High	High	Moderate	Low	Low

Source: Oliver (1999)

The framework should be analysed from the left. If a hybrid has low legitimacy and multiple constituents that it must respond to, then the best strategy to adopt is Manipulation, which integrates stakeholder interest in decision making and actively shares with institutional field constituents to influence policy (Oliver, 1991). The passive strategies could lead to dominance of one institutional logic over another, whereas proactive management based on company objectives could lead to paradoxical harmony, provided that the internal pressures are balanced, as will be demonstrated by Pache and Santos' (2010) framework below,.

2.2.5.2 Response to conflicting institutional demands

Pache and Santos (2010) extended and built on Oliver's (1999) model, as they believed it had weak predictive power in specifying the appropriate resistance strategy for managing conflicting demands. They extended the model by ruling-out acquiescence as a weak strategic response and incorporating the nature (means versus goals) of institutional conflict interacting with the degree of internal representation (absence, single, or multiple). Means (courses of action) refer to when the institutional conflict affects the organisation at a functional level, versus goals which is when the organisation is affected at an ideological level, prescribing which goals are legitimate to pursue. The model goes beyond the external environment and addresses how organisations can respond to internal conflicts caused by competing institutional logics, challenging the notion that organisations are constrained by internal

environments. Internal representation, as depicted below, refers to either single (one-sided) or multiple (two-sided) representations of the competing logics in the organisation.

Figure 3: A model of responses to conflicting institutional demands

Response Determinants		Likelihood of Adoption of Response Strategies			
Nature of Demands	Internal Representation of Demands	Compromise	Avoidance	Defiance	Manipulation
Means	Absence	High	High	Low	Low
	Single	Low	High	High	Low
	Multiple	High (balanced power)	Low	Low	High (unbalanced power)
Goals	Absence	Low	High	High	Low
	Single	Low	High	High	High
	Multiple	Low	Low	Low	High ^a

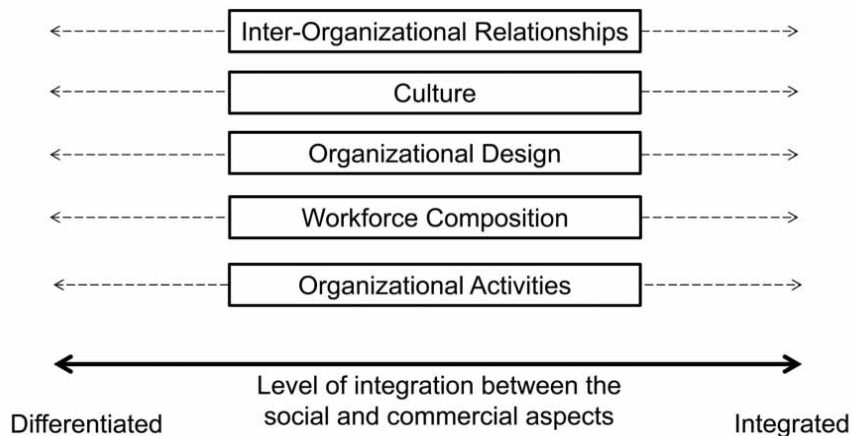
Source: Pache and Santos (2010)

The model is interpreted from the left, predicting which strategy is likely to be adopted depending on the nature of the demand. For example, should there be a strategic conflict regarding which goal should be pursued, and there is no representation of the social logic internally, it would be highly likely that the strategy adopted is either avoidance or defiance of the demands of the social logic, and a purely profit motivated goal is pursued. In cases where there is a balance of power on both sides of the representation, and the nature of the demand is on which action to take (means), conflict may persist, causing organisational paralysis or even break-up should the manipulation strategy be adopted, as they will fail to reach consensus. The compromise strategy is thus a better fit to avoid paralysis. Pache and Santos (2010) emphasised that it is important for each logic to be represented internally, to achieve a paradoxical harmony.

2.2.5.3 Hybrid organising

Battilana and Lee (2014) attempted to respond by suggesting that the tensions of hybrid organisations should be managed by a framework termed ‘hybrid organising’. Hybrid organising was defined by the authors as the activities, structures, processes and meanings by which organisations make sense of and combine aspects of multiple organisational forms. Battilana and Lee’s (2014) model identified five dimensions of hybrid organising as per Figure 4 below.

Figure 4: Dimensions of hybrid organising



Source: Battilana and Lee (2014)

As per the above:

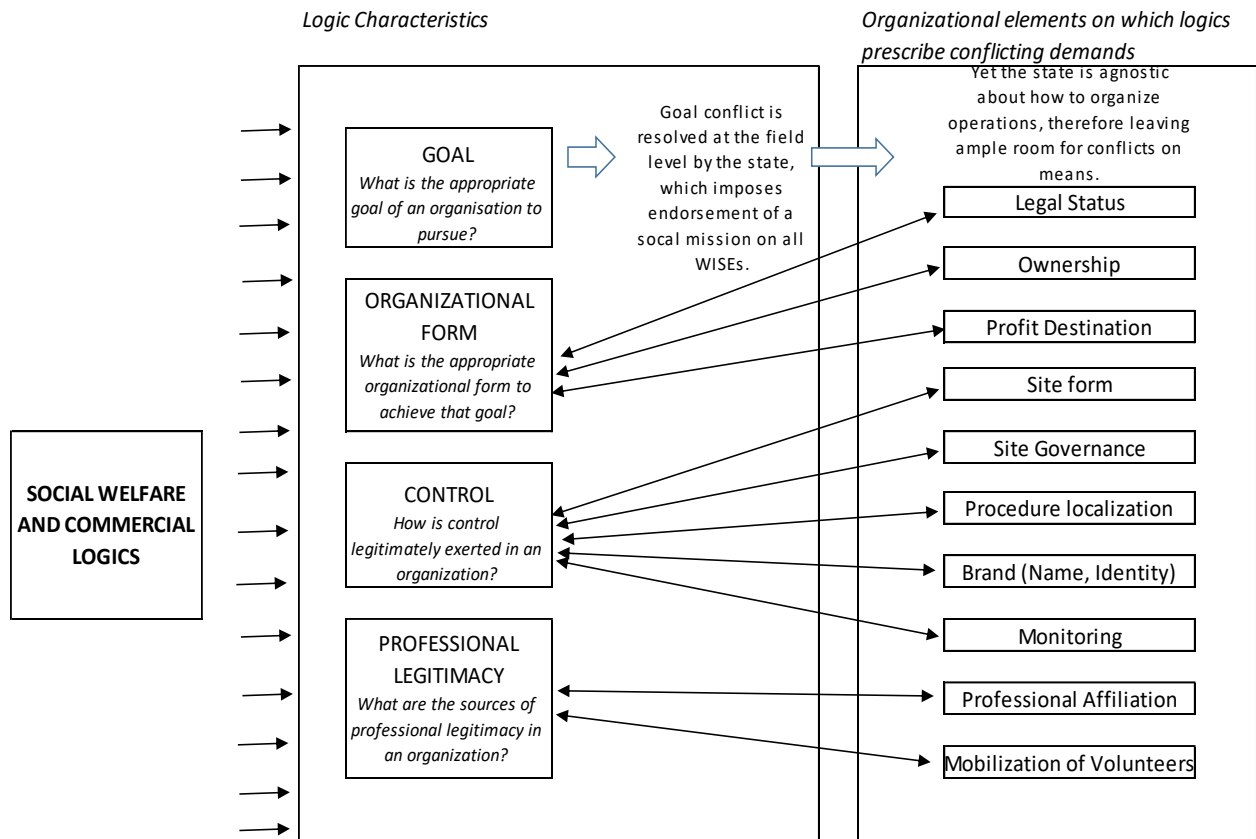
(i) Core organisational activities refer to the specific set of activities in which an organisation engages. Effective hybrid organising entails the integration of activities that achieve the social and commercial objectives to gain external legitimacy. (ii) Workforce composition dimension draws from the literature on employee commitment based on value alignment to organisational values. Battilana and Lee (2014) proposed that effective hybrid organising requires individuals to embrace the organisation's hybridity and share in its values. (iii) Organisational design refers to the formal translation of strategy into action through the structure, incentives and control system, and governance. Hybrid organising effectively requires a centralised structure, a reward system that measures performance based on the social and commercial aspects, and a governance board that holds the organisation accountable on the basis of both logics. (iv) The researchers argued that it is desirable for organisational culture to be integrated, however they acknowledged that the cultural patterns are likely to vary depending on how integrated the other dimensions are. (v) Inter-organisational relationships may impact hybrid organising as the organisation interacts with external forces either through financing or strategic partnerships. It is important that the relationships are managed accordingly and not allowed to influence the hybridity of the organisation. Finally, in hybrid organising, Battilana and Lee (2014) acknowledged attempts by leaders of hybrid organisations to influence broad field-level actors in order to gain legitimacy.

2.2.5.4 *Selective coupling*

Pache and Santos' (2013) study on social enterprises as hybrids identified 'selective coupling' as the best strategic response to intra-organisational processes of hybrid organisations. Selective coupling refers to the purposeful enactment of selected practices among a pool of competing alternatives, which focuses on internal organising. The research focused on coupling the following ten elements: legal status of the entity, ownership structure, profit destination, site form, site governance, procedure localisation, brand identity, monitoring, professional affiliation and mobilisation of volunteers. The elements are grouped into four characteristics of the two competing logics: (i) the goal of the organisation determines the activities it carries out; (ii) the organisational form determines ownership structure and drive for commercial success; (iii) the governance mechanism differs as the social impact logic could work with a democratic sharing of power whereas the for-profit logic would be hierarchical; and (iv) professional legitimacy differs as it could drive investment flows whether one is seen as an investment professional or as a non-profit organisation.

The coupling refers to choosing, for example, a for-profit legal status which satisfies the commercial logic, however the profit destination is a non-profit entity or the shares of the company owned by a non-profit entity. Pache and Santos (2013), building on the understanding that occupational groups and professionals are powerful carriers of institutional logics, reviewed the organisational origins as determinants of selective coupling matters, and identified that the social enterprises originating from the commercial sector endorsed the social demands more as a way of creating legitimacy, whereas the enterprises with social origins showed a more balanced combination of the demands. Brandstetter and Lehner (2015) supported this view from an internal organising point of view, by stating that the generation of impact should be integral to the organisation's business strategy, operations and revenue model. Figure 5 below shows the characteristics of the competing logics and the elements that show the dominant logics.

Figure 5: Data structure of selective coupling



Source: Pache and Santos (2013)

2.2.5.5 Conclusion

The models presented, provide a comprehensive view on achieving paradoxical harmony in Impact Investing. Together, the models considers the organisations' external operating environment, which is a key argument for Impact Investing and they also consider the internal environment which drives innovative thinking of how to optimise impact without sacrificing financial returns. Oliver's (1991) suffers from impracticality, however, it was foundational for succeeding studies like Pache and Santos' (2010), which moved the model one step further by considering institutional actors. The two models however, fail in integrating the external operating environment. Battilana and Lee's (2014) hybrid organising continued to look at internal organising and moving the theory forward by considering comprehensive dimensions that are critical for organisational success. Pache and Santos' (2013) selective coupling model contributes to theory by adding elements from the external environment that enable the organisation to gain legitimacy in the market.

2.3 Impact funds

The stakeholders, or actors, in the Impact Investing can be divided into four broad categories: asset owners who actually own capital (investors); asset managers who deploy capital (fund managers); demand-side actors who receive and utilise the capital (social enterprises); and service providers who help make this market work (researchers and consultants) (Jackson, 2013). Impact investment funds are composed of shares in companies with high scores on such social responsibility characteristics as community, employee relations, and the environment (Statman & Glushkov, 2009). Of the various strategies that are described in the literature on Impact Investing, Scholtens (2014) listed seven, which broadly consisted of screening, ESG theme incorporation and shareholder advocacy, with which Glac (2009) agreed. The 2016 GIIN Annual Survey reported that the largest number of respondents invested in businesses that sell products or services benefitting a specified target market, and invest in a way that catalyses employment in a target population.

Screening includes negative screening, which refers to the practice of excluding companies with negative social or environmental impacts from a portfolio, and positive screening, which refers to the active search and inclusion of companies with a positive impact (Humphrey & Tan, 2014). ESG themed (sustainability themed) refers to investments in assets that are linked to ESG or sustainability factors (Scholtens, 2014), while shareholder advocacy refers to investments in companies which are open to shareholder activism. Impact investors have varying concerns, some of them being labour issues (sweat shops), product safety (sin stocks – tobacco, alcohol and gambling), executive compensation and the environment (Statman, 2005). Statman also highlighted that a company may be thought of as socially responsible based on one factor, and socially irresponsible on another.

2.3.1 Construction of an Impact Fund

The Noble Laureate, Harry Markowitz, first wrote on risk diversification and return maximisation in 1952 when he introduced Modern Portfolio Theory (MPT) for asset selection. The theory asserts that returns will be maximised through the construction of an asset portfolio, which efficiently compensates taking on high risk with high financial returns (Markowitz, 1999). Risk in MPT is measured as the standard deviation, which is the square root of the statistical measure variance, calculated as the squared average of the differences of data points and the mean (Markowitz, 1999). This reflects how volatile the returns are (Swisher & Kasten, 2005). The theory asserts that there is an efficient portfolio which is diversified by the inclusion of all companies that will increase the returns of the portfolio without increasing risk. Stagers (2014) argued that a diversified portfolio approach reduces financial risks, however a strong qualitative asset selection process mitigates counterparty risk and management overheads of

the portfolio over the term of the fund, therefore the asset selection process is important in ensuring the success of the impact fund. The 2016 GIIN Annual Survey found that of the respondents who discussed the due diligence process, approximately 47% had the same process as conventional investors, 29% added impact screens to the process, and the remaining had substantive differences from the conventional investing process.

2.3.2 Defining risk

In Impact Investing, it is generally assumed that a firm's ethical characteristics are not reflected in its other investment characteristics, such as the variance which measures risk in MPT (Farmen & Van De Wijst, 2005). The strategy thus excludes companies that do not fit its value system, it effectively limits diversification, and it should theoretically result in lower risk-adjusted-returns (Renneboog, Horst & Zhang, 2008; Blanchett, 2010). Neil (2016) agreed by stating that the greater the restrictions due to impact factors, the harder it is to build a portfolio of assets with adequate risk diversification. Therefore, in that case, the theory would imply that there is a cost to Impact Investing in the form of reduced risk-adjusted returns should the excluded companies have superior returns, however should the excluded companies perform poorly, the impact fund would outperform the market (Farmen & Van De Wijst, 2005).

The modern portfolio theory is not without criticism for its singular view of risk-return analysis, as studies in behavioural finance have found investment decision making to involve other emotional and situational factors besides risk (Peylo, 2012; Steuer, Qi, & Hirschberger, 2007). In supporting the incorporation of behavioural finance in investment decision making, Swisher and Kasten (2005) stated that to ensure that any theory of risk is supported by observation, one should test any risk definition against how humans actually behave to determine if the definition is accurate. This disregard of sustainability factors in portfolio theory has resulted in many investment managers not considering non-financial factors in portfolio construction (Bilbao-Terol, Arenas-Parra, & Canal-Fenandez, 2012). The biggest flaw of MPT, argued Swisher and Kasten (2005), is that standard deviation is not risk as it does not fully capture complex human emotions, which may be hard to quantify mathematically, but equates to the concept of risk which involve much more than volatile returns. The substantial growth in Impact Investing has not altered the profit maximisation view of the firm (profit logic), however it is impacting the way financial risk is conceptualised and alerting companies that their practices may be publicly questioned or challenged (King & Gish, 2015).

2.3.3 ESG risk

Central to portfolio construction is the understanding and measurement of investment risk of each asset, which is conventionally calculated as a standard deviation (square root of variance) (Steuer, Qi, & Hirschberger, 2007). The hybrid goals concept of Impact Investing

increases complexity when it comes to the two-framed portfolio theory of risk-return analysis however (Brandstetter & Lehner, 2015). King and Gish (2015) stated that responsible investing has changed the investment landscape and introduced a new element when calculating investment risk, which is consideration of social and environmental factors. They further stated that this will involve an analysis of the sustainability of the industry that the company is operating in and a continual assessment performed by practitioners on progress, strategies and the evolution of ESG (King & Gish, 2015). This analysis will lead to the identification of best-in-class, which will enhance the impact performance at both deal and portfolio level. Peylo (2012) found sustainability factors to adequately enhance the traditional financial framework of investment analysis, therefore it is important that ESG risk is considered in portfolio construction. The 2016 GIIN Annual Survey defined ESG risk as risk derived from non-compliance with ESG factors.

Hayes (2005) claimed that the investment climate is rife with corporate scandals of significant financial impact, hence investors are shifting towards responsible investing as decreased employee turnover, increased customer loyalty, and reputable financial reporting is said to lead to higher returns for shareholders. Peylo (2012) supported this view by stating that, as social or environmental violations often strongly affect equity prices (exemplified by the impact of oil spills on British Petroleum shares), rational investors should consider responsible investing screens when making investment decisions. Snider (2015) stated that companies that demonstrate ESG prudence have been able to reduce risk and potentially enhance shareholder value.

Radu and Funaru (2011) proposed that social, ethical and environmental screening may reduce the high costs that emerge during corporate social crises or environmental disasters. These costs will include fines levied on the companies, costs of loss of production due to employee stand-offs or sales losses due to customer boycotts, and costs of environmental and reputational rehabilitation. Renneboog, Horst and Zhang (2008) concurred by suggesting that the two reasons as to why high impact stocks might outperform in the market are firstly, that sound social and environmental performance signals good managerial quality, which translates into favourable financial performance; and secondly, social and environmental screening reduces the possibility of incurring high costs during corporate social crises or environmental disasters, which financial markets tend to undervalue. Neil (2016) asserted that better screening for ESG risks which affect the social impact of the investment can also reduce the financial risks and improve performance.

2.3.4 Challenges

Stagars (2014) stated that investors are concerned about investment risk, pipeline of investment opportunities, the management of investments and insufficient demand from private and institutional investors creating exit issues. The UNDP report on Impact Investing identified several challenges faced by impact investors, which included difficulty sourcing viable investments, limited innovative fund and deal structures, and difficulty exiting investments. The 2016 GIIN Annual Impact Investing Survey reported that respondents identified business model execution and management risk as top risk contributors, whereas liquidity and exit risks were ranked second. These were followed by market demand and competition, financing risk and country and currency risk (GIIN, 2016). Neil (2016) identified that Impact Investing often involves unproven business models, difficult to reach and unstable markets, start-ups or early stage enterprises, entrepreneurs and fund managers without track records, and frontier markets risks. Neil added that impact investors often layer these risks, combining multiple risk factors in one fund, which makes this investment approach high risk.

Stagars (2014) asserted that most of these concerns can be mitigated with financial structuring and a transparent, stringent asset sourcing process. He added that when assets undergo a stringent qualitative assessment process before investment, a fund manager may decrease overheads and tilt the focus away from a hands-on management approach to more of a monitoring and benchmarking function during the life of the fund. Neil (2016) commented that investors can reduce the risk of holding illiquid assets by considering the exit route at the time of investment. He continued that perhaps the best way to mitigate liquidity risk is the appropriate selection of a sponsor (management or shareholders of the investee companies) as if a sponsor is unwilling to cede control or be diluted as the business grows, this will constrain the scope for exit (Neil, 2016). Jones and Turner (2014) recommended that donors and philanthropists de-risk private investments through various mechanisms, including technical assistance grants, funding for financial ecosystem development, and financial instruments including catalytic first loss capital, debt guarantees, and other forms of blended finance.

2.3.5 Finance structure

Impact Investing, asserted Neil (2016), is an investment approach that covers a range of equity and debt types of instruments with different risk-reward profiles. Hochstadter and Scheck (2014) agreed, reporting that Impact Investing can occur across different asset classes and financial instruments including equity, debt, guarantees and deposits. The 2016 GIIN Annual Survey reported that private equity and private debt are the most common financial instruments used, however the overall allocation to private debt is much higher than that to

private equity, reflecting the fact that some large investors allocate much more of their capital to private debt. The variation of possible financial instruments and the tension of the impact and profit logic present an opportunity for innovation, as alluded to by King and Gish (2015), in the form of innovative financial structures. The South African market has not experienced exciting innovations, however the European market pioneered innovation in this space by the creation of Social Impact Bonds (SIB). SIB are defined in Hochstadter and Scheck's (2014) study as a type of outcome-based contract where private investors finance social interventions; the investors receive a financial return from the public authorities if the predefined social outcome materialises.

Neil (2016) stated that it is important to ensure that there is a match of instruments to investments types, for an example start-ups and early stage enterprises need patient capital and hands-on guidance, therefore Angel investors and venture capitalists will be appropriate, whereas growth phase investments need large investments and have to professionalise their management, therefore private equity investments would be appropriate. Hochstadter and Scheck (2014) reported that impact investments typically target small enterprises and growth stage businesses, followed by venture-stage businesses. Investments in mature publicly traded companies are rare. Neil (2016) commented that debt can be an appropriate instrument to finance growth stage and mature companies, and as loan covenants could be incorporated, it provides an opportunity for the investors to bind the investee to social performance standards.

2.4 Financial performance

There are a lot of studies on the subject of Impact Investing, many of which have assessed the performance of impact investment funds (Viviers & Eccles, 2012) in order to determine if these investments are risky, implying a cost to Impact Investing. The 2016 GIIN Annual Impact Investing Survey, however, reported that 59% of the respondents primarily target risk adjusted returns whereas 25% target returns that are, below but closer to market rate returns and 16% target returns that are closer to capital preservation.

2.4.1 Factors affecting performance

Performance could be greatly influenced by the ecological and social performance of the companies that form the holdings of the funds (Stankevičienė & Čepulytė, 2014). The 2016 GIIN Annual Survey reported that the actual performance compared to expectations, and found that respondents with below market expectations generally had lower mean return expectations to market rate investors. This could result from the fact that managers with below market expectations have a high-risk tolerance, however, it could also be due to the skills of

the asset managers involved, that is, the funds' performance has been influenced by human and intellectual capital efficiencies (Stankevičienė & Čepulytė, 2014). This is supported by Statman and Glushkov (2009), who stated that performance is affected by the asset selection skills and fees charged by the portfolio manager.

Peylo (2012) noted that social and environmental factors often impact equity prices. This view, argued Adler and Kritzman (2008), disproves Fama's (1970) hypothesis on efficient markets' ability to quickly reflect new information in prices (Farmen & Van De Wijst, 2005). If new information was quickly reflected in stock prices, i.e. if markets were efficient and impact factors positively affected stock prices, then the companies would need to be constantly seeking new, innovative ways of being socially responsible for them to produce superior returns (Adler & Kritzman, 2008). Renneboog, Horst and Zhang (2008) further expanded on this, stating that the assumption underlying the outperformance of impact stocks in the short term is that the stock markets misprice information on impact, which is not readily available. That is, sustainability of assets is mispriced, resulting in high impact companies being mispriced in the market, providing opportunities to speculative investors to make elevated returns. Farmen and Van De Wijst (2005), using Modern Portfolio Theory and the Efficient Markets hypothesis, hypothetically came to a contradictory conclusion that there is, in fact, a premium paid by impact investors under the assumption that markets are not efficient.

2.4.2 Performance comparison

Using a four-factor model, Renneboog, Horst and Zhang (2008) and Mollet and Ziegler (2014) could not conclusively support a positive relationship between stock returns and socially responsible investments. Renneboog, Horst and Zhang (2008), when comparing the performance of socially responsible funds to conventional funds, could not find statistically significant evidence that socially responsible investment funds underperform conventional funds, even though the results showed the funds were underperforming compared to the respective benchmarks. Focusing on Australian funds, Bauer, Otten and Rad (2006) also did not find any difference between the performance of socially responsible funds and conventional funds. These statistical comparisons used a lot of estimates and are subject to many biases and adjustments, however as Viviers and Eccles (2012) found, the majority of the studies on performance report that there is no significant difference between conventional investing and SRI. In addition, approximately a quarter of the studies found that SRI funds outperform the market, validating the investment approach. The difference in results of the numerous empirical studies (Hayes, 2005) on the performance of the SRI funds show a gap in the literature with regards to whether there is a cost to impact investments, but these inconclusive results have not deterred capital flows into the impact space (Benson & Humphrey, 2008).

2.4.3 Screening

Statman and Glushkov (2009) isolated the two screening strategies when they analysed the returns on impact funds for the period 1992-2007, whereas Auer (2016) only assessed the impact of negative screening on performance. Statman and Glushkov's (2009) results show that positive screening was advantageous when compared to conventional funds, whereas funds using negative screening was a disadvantage resulting in a netting-off effect, hence no significant difference was seen when compared to conventional funds. Auer's (2016) results showed that responsible investing in the form of negative screening does not add surplus value. Snider (2015) agreed by stating that the integration of impact factors, such as negative screens, can amplify risk by eroding diversification and causing unintended concentration exposure to specific firms or sectors that can result in a portfolio's failure to perform in line with a benchmark or achieve an expected rate of return. The result of these studies suggests that there could be a cost to negative screening as best performing companies could be ignored, whereas positive screening could result in superior returns. To mitigate this, Neil (2016) stated that investors should think carefully about the impacts they are aiming for, and avoid being too prescriptive about the actual investments which deliver impact, i.e. investors should aim to invest in best-in-class assets. This will entail, as explained by Stagars (2014), a strong qualitative vetting process.

2.5 Measurement of Impact factors

Measuring the impact of an investment is a key component of Impact Investing (Jackson, 2013), however there is lack of performance measurement metrics that fully integrate the impact factors as the current models are based only on financial returns (Brandstetter & Lehner, 2015). The reason for this is that impact information is more difficult to obtain than financial return information, and there is no effective way of knowing whether the assets included in an impact portfolio are actually impactful (Farmen & Van De Wijst, 2005). Jones and Turner (2014) agreed by stating that financial returns are straightforward to measure, whereas the measurement of social impact is much more complicated. Farmen and Van De Wijst (2005) warned that the portfolio will have to be managed using a passive investment strategy, as the market for impact assets is inefficient due to a lack of information on the companies' social and environmental impact. Snider (2015) had a positive view on current developments, stating that there is now an increased level of impact data on companies that fund managers can use to review investments.

Measurement is critical as it assists in monitoring impact risk, which is defined as a measure of uncertainty that an organisation will deliver on its proposed impact (Brandstetter & Lehner, 2015). The 2016 GIIN Survey reported that almost all of its respondents, that is 95%, believed

measurement of impact is very important as it is part of their mission and it assists in understanding and improving impact performance. The report even quoted one respondent as having said that “Our internal company culture and morale is driven by responsible investment, and so we are each personally interested in the outcomes of our work. So internal communication of impact should not be underestimated” (p. 43). The report also mentioned that 65% of the respondents stated that contractual commitments are a driver of impact measurement.

2.5.1 Measurement tools

Most studies interested in the performance measurement of impact funds use Fuzzy Multi-Criteria decision making models in order to incorporate impact factors (Bauer, Otten, & Rad, 2006; Bilbao-Terol, Arenas-Parra, & Canal-Fenandez, 2012; Reenneboog, Horst, & Zhang, 2008). These studies mathematically score impact factors (Auer & Schuhmacher, 2016) in order to determine portfolio performance (Reenneboog, Horst, & Zhang, 2008) and assess their impact on stock performance (Galema, Plantinga, & Scholtens, 2008). Van der Ahee and Schulschenk, (2013) found that the greatest barrier to Impact Investing in South Africa is a lack of measurement tools. There has, however, been a number of measurement tools developed by various parties, including Impact Reporting and Investment Standards’ (IRIS) Global Impact Investing Rating System (GIIRS) and the B Impact Assessment powered by B Lab (Brandstetter & Lehner, 2015). The 2016 GIIN Annual Survey reported that equal numbers of impact investors use proprietary metrics as those using standardised frameworks aligned with IRIS. Jackson (2013), however, contended that current practices in the evaluation of Impact Investing still tend to focus on counting inputs and outputs, as well as telling stories, funds invested, number of people reached or served, and profiles of local entrepreneurs, which are all useful but are not sufficient. Jones and Turner (2014) concurred by stating that it is important in Impact Investing to understand the social outcomes and impacts which require additional qualitative reviews that are not currently widespread.

Haigh and Guthrie (2010) found that even when the government regulated the reporting by socially responsible investment managers in Australia and New Zealand, the managers were still not reporting on these factors, arguing that the information was not useful to the investors. The managers, believed Haigh and Guthrie (2010), used fluid and dynamic processes, which varied over time and across the industry. Perhaps the biggest difficulty with measuring impact, said Farmen and Van De Wijst (2005), is that social and environmental impact could be achieved by varied methods. Investment managers may also have different views on which factors are important for increased social welfare, and the measurement of these factors will also differ from manager to manager (Hallerbach *et al.*, 2004). Jackson (2013) suggested that the ‘Theory of Change’ should be the third element to the definition of Impact Investing, as it

is a cost-effective way of framing and informing an evaluation of impact. He argued that it can be used in conjunction with a wide range of other data collection and analysis methods, therefore it is not impossible to measure impact and manage an impact fund as the studies show.

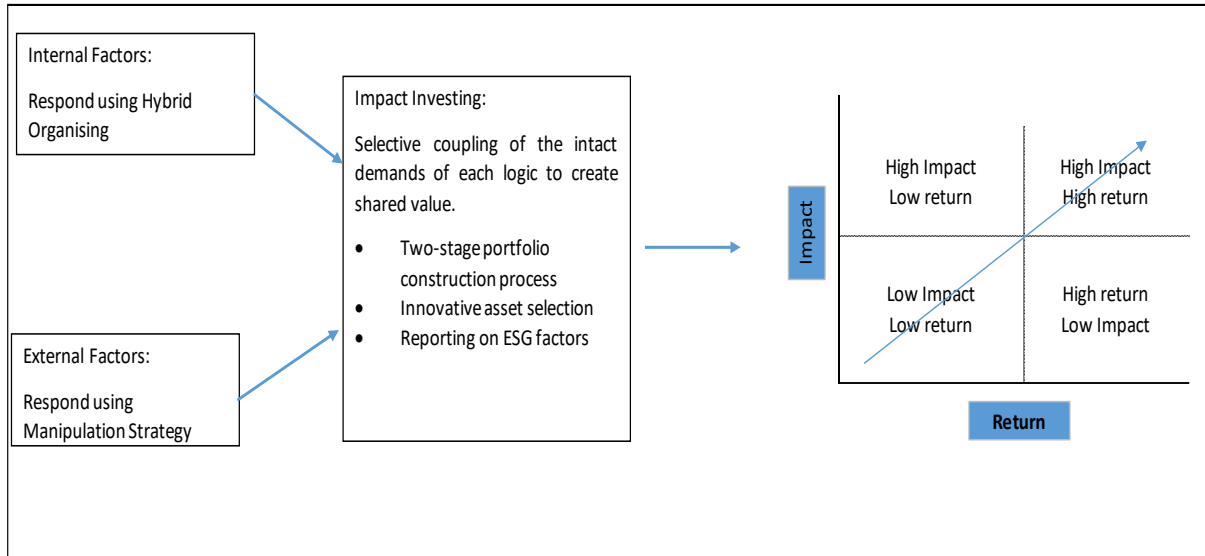
2.6 Conclusion

The extensive research performed on Impact Investing was informative in framing the questions for this study, as it revealed disparities in the understanding of this investment strategy. Empirically, the scholars' research methods and definition of what Impact Investing is failed to answer the question of whether there is a cost to Impact Investing. The understanding of what Impact Investing is, framed under the Institutional Logics, Stakeholder, Paradox and Hybridity theories, is insightful, as various models and frameworks derived from these theories gets the field closer to a strategic response to the trade-offs of Impact Investing. Impact Investing is not just a new fad but has dented the renowned finance theories of risk analysis as the best tool for creating value. Yet the literature also shows that a huge gap in the measurement of non-financial factors exists, questioning the legitimacy of the field.

The question of how could be answered, as some theorists have implied, by creatively adopting an ambidextrous strategy of integrating, in decision making and internal processes, demands of both the socio-environmental impact logic and profit logic of Impact Investing. To achieve paradoxical harmony, the balance needs to be driven by a common purpose, entrenched in the identity of the organisation that is understood by all institutional actors. There is a risk that due to a lack of information on companies' socio-environmental performances, that irresponsible companies may be included in an Impact Investing fund. To overcome this, researchers suggest a two-stage portfolio construction process, where assets are first screened for non-financial factors, then screened for financial factors.

Figure 6 below is a framework adopted from the literature findings, which addresses how Impact Investing can be executed. The Impact Investing firm has to align the values internally in the form of hybrid organising, as suggested by Battilana and Lee (2014), incorporated with Oliver's (1999) suggested manipulation strategy, to actively align with the external environment, as the legitimacy of the strategy is low and there are multiple constituents. Selectively coupling these in the cognitive frame of the firm (Pache & Santos, 2013) and using a two-stage process for portfolio construction will lead to a high impact firm with maximum returns.

Figure 6: Impact Investing Framework



Chapter 3: Research Questions

3.1 Introduction

The literature proves an existing paradox in hybrid organisations, and there is consensus on how the complexity of managing the competing logics in these organisations should be managed by achieving equilibrium. Yet the literature does not delve into the practicality of achieving this equilibrium, what the different dimensions of the trade-offs are, and how the non-financial factors should be measured to indicate the utility earned from them. This study is specifically focused on Impact Investing, with the purpose of supporting the legitimacy of this hybrid as an alternative source of funding for socially and environmentally responsible enterprises. In seeking practical solutions to achieving a balance and measuring non-financial factors, the below questions will form the frame of the analysis.

3.2 Research Question 1

What factors do impact investors consider when constructing an investment portfolio?

3.3 Research Question 2

What are the trade-offs (or impending risks) of Impact Investing? This refers to both financial and non-financial risks.

3.4 Research Question 3

How do impact investors achieve a balance between the competing logics of profit maximisation and socio-environmental impact?

3.5 Research Question 4

How do impact investors measure socio-environmental returns (impact returns) and is impact measurement incorporated in the overall measurement and reporting of company performance?

Chapter 4: Research Methodology

This chapter provides an overview of the methodology used to conduct this research. A qualitative study performed through a series of in-depth, semi-structured interviews with experts and practitioners was relevant in deciphering the trade-offs in Impact Investing.

4.1 Research design and strategy

The increasing asset flows in Impact Investing has legitimised the investment strategy, however empirical research in the field is in its infancy due to varying definitions and investment strategies, ranging from investment screening to environmental, social and governance (ESG) integration in strategy, and thematic investment strategies. The lack of consensus on performance measurement metrics and reporting of non-financial factors and their impact on wealth creation has resulted in difficulty for asset managers seeking to incorporate non-financial factors in decision making. Furthermore, the risks of Impact Investing and assumed costs are not fully understood. Therefore, to better understand the trade-offs in decision making by impact investors, a qualitative study was performed. This method was relevant as it aimed to produce or promote solutions to the practical problems (Flick, 2007) faced by impact investors.

An exploratory study was a good fit, as the objective of the research was to gain new insights into the Impact Investing organisational field. In-depth, semi-structured interviews were held with experts and practitioners, where predetermined, thematic questions were asked (Saunders & Lewis, 2012). These were relevant in order to gain insight into the process of selecting assets for portfolio construction and understanding the relationship between social impact and financial returns based on past performance.

4.2 Population

This study was focussed on Impact Investing, and therefore, using the definition of Impact Investing per the GIIN, the population was limited to Impact Investing activities that displayed the following characteristics:

- The investment strategy must have hybrid goals of generating impact and financial returns.
- The investment strategy must be intent on being socially or environmentally impactful.
- The non-financial factors must be measurable.

The population of this study was a group of experts and practitioners involved in Impact Investing strategies that displayed all of the above characteristics. The definition was not

limited to a structure, therefore the population included any individual or juristic person involved in Impact Investing. Contextually, the study was limited to South Africa, thus the population for this study included all experts and practitioners involved in Impact Investing in the country. The Bertha Centre's Impact Investing Barometer was a good snapshot of the organisational field of Impact Investing in South Africa, however as it was limited to investment vehicles, it did not comprehensively capture the population for Impact Investing and it therefore could not be used for this study. As there was no formal representation for the population, the total size of the population was assumed to be unknown for this study.

4.3 Sample

It is important that decisions which have significant consequences be made based on evidence, and evidence about a population can be obtained from a sample that is systematically the same as the said population (Easterby-Smith, Thorpe, & Jackson, 2015). In the case where there is no sampling frame (i.e. the population is unknown), non-probability sampling can be used to obtain evidence (Saunders & Lewis, 2012). Purposive (judgemental) sampling is applied by researchers when actively choosing those who will best be able to help answer the research question and meet objectives (Saunders & Lewis, 2012). Purposive sampling is argued to be best suited when aiming for certain characteristics in a sample (Giampietro, 2004). Therefore, as the definition of Impact Investing is restrictive in terms of what the investment strategy should have, a judgmental sample of 15 investment professionals and researchers was selected in order to answer the research questions.

Flick (2007) stated that when selecting a purposive sample, the criteria that could be applied are whether the respondent has experience on the topic of study, or whether they are in a position to apply the professional practice the researcher is interested in. Therefore, the sample was selected based on the experience and knowledge of the experts and practitioners, also considering their proximity to the research questions. The selection was based on the condition that the respondents had two or more years of experience in Impact Investing. Saunders and Lewis (2012) stated that should it be difficult to locate the members of a population for testing, snowball sampling, which is a method of sampling whereby the first sample (member) is used to locate subsequent members, should be used, therefore snowballing was used in selecting the sample.

4.4 Unit of analysis

The unit of analysis of this study was the perceptions and responses to the paradox of Impact Investing by Impact Investing experts and practitioners.

4.5 Data collection

4.5.1 Data collection tool

Data was collected using 15 semi-structured interviews with Impact Investing experts and professionals. In the case where face-to-face interviews could not be conducted, audio-calling was used. Johnson (2001) stated that in-depth interviews are appropriate when the topic of study involves highly conflicted emotions, and where different individuals in the same line of activity have complicated, multiple perspectives on some phenomenon. This method was relevant for this study in order to provide a rich exploration of the perspective and actions (Johnson, 2001) of the respondents on the paradox of Impact Investing. The interviews were semi-structured, whereby the questions were non-standardised and listed based on themes (Saunders, Lewis & Thornhill, 2000). An interview guide, which is attached as Appendix 1, was used to ensure quality, relevance and ease of collecting and analysing the data (Saunders & Lewis, 2012).

Each interview was timed to run for a period of 45 minutes, however as semi-structured interviews allow for additional questions to be asked in order to find out further details and explore objectives in more depth (Saunders & Lewis, 2012), a provision for 15 more minutes was made where necessary to enrich the data. The respondents were alerted beforehand that for accuracy and subsequent referral, the interviews were to be audio-recorded. A consent form (Saunders & Lewis, 2012) was thus developed and a request made for the respondents to sign it. Probing techniques were used as suggested by Saunders and Lewis (2012), where the respondent brought-up new or interesting concepts.

4.5.2 Interview guide

Saunders and Lewis (2012) recommended that when performing semi-structured interviews, a thematic interview guide, the order of which may change based on the respondents' responses, should be used. Rapley (2004) affirmed this view by stating that it is useful to prepare questions beforehand based on your topic in order to obtain sufficient evidence. As the interviews were semi-structured, a thematic interview guide consisting of 23 questions (see Appendix 1) was used. Four questions were added after the pilot interviews, which is consistent with Rapley (2004) and Saunders and Lewis (2012) who stated that, to attain rich and adequate data during research, questions should be adapted over the cycle of the project based on new insights or based on the respondents.

Rubin and Rubin (2005) warned, however, that although an interview guide may be directive, forthcoming respondents may take over the interview and provision should be made as they

may provide rich descriptions. The questions, which were derived from the discussion in the literature, attempted to provide answers to the research question and give a rich understanding of the trade-offs of Impact Investing in order to assist decision-makers to refine their investment processes.

4.5.3 Pilot test

A pilot test is a try-out of the interview process with a similar group of people as the research respondents, in order to ensure the sufficiency and relevance of the interview questions (Saunders & Lewis, 2012). This enables a revision of the interview guide so that respondents have no problem answering and that there are no issues in recording the data (Saunders, Lewis, & Thornhill, 2000). Two pilot interviews were performed in order to test the interview style and the researcher's ability to read non-verbal clues, and to see whether the questions needed to be revised to achieve the objective of the study. The interviews were insightful and provided an opportunity for the interview guide to be refined.

The pilot interviews ran for approximately 40 minutes, allowing for more questions to be added, especially since they revealed that risk appetite and mitigation methods needed to be explored in order to obtain sufficient data to promote or produce practical solutions. Four more questions were added after the pilot interviews.

4.6 Data analysis

In-depth, semi-structured interviews were used as a data collection tool, therefore topic of talk was the focus of analysis. The data collected were then transcribed (Roulston, 2014) in reference to what actually happened. This is supported by Rapley (2004), who stated that interview data should be analysed in reference to what actually happened, taking into account the interaction that produced the trajectory of talk, how the specific versions of reality were constructed, and how the specific identities, discourses and narratives were produced. To capture the substance of discussion, Roulston (2014) suggested that transcripts need to capture how the message was contextually delivered, including the non-verbal clues (and sounds made, hesitations, jokes, etc.) that fill long pauses, possibly indicating the sensitivity of the information. This was a relevant consideration as financial performance data that is not required to be disclosed and questions related to ethics, which formed the basis of this study, were discussed.

4.6.1 Qualitative data analysis

Saunders and Lewis (2012) suggested that qualitative data should be analysed before it is all collected, as it allows for the follow-up of initial insights suggested by early interviews in later

interviews and enables recognition of saturation. Rubin and Rubin (2005) confirmed that follow-up questions, which could be formulated from the analysis of earlier interviews, are crucial for obtaining depth and can help in obtaining more nuanced answers. Therefore, to significantly improve the quality and depth of the evidence collected, data were analysed as and when collected.

4.6.2 Content analysis

The approach adopted in-order to analyse the data was induction, which involved the development of theory as a result of analysing the data already collected (Saunders & Lewis, 2012). Content analysis, which involves analysis of the content and frequency of the text (Eriksson & Kovalainen, 2008), was then used as a technique to analysis the data. The text was coded using computer-aided qualitative data analysis software (CAQDAS) called Atlas.ti. Coding involves taking raw data and raising it to a conceptual level (Eriksson & Kovalainen, 2008). This interaction with data results in development of rich theoretical insights (Eriksson & Kovalainen, 2008). The themes developed were then mapped to the research questions of this study in order to achieve the main objective.

4.7 Research limitations

Research limitations for this study were:

- The research study was limited to experts and practitioners based in South Africa, and therefore their views may have been contextually biased to their operating environment.
- The research is based on a non-probability sampling of 15 professionals of an unknown population. It thus had inherent limitations of non-probability sampling regarding population representation. Furthermore, generalisation might be a concern (Saunders & Lewis, 2012).
- Purposive sampling is based on the judgement of the researcher, therefore sample bias was a concern as the researcher's views and beliefs might have impacted the sample selection.
- Due to the intimate setting of the in-depth, semi-structured interviews, there were concerns regarding data analysis bias as the researcher's views, beliefs and experience might have affected data analysis or resulted in a loss of contextual meaning.
- The researcher has no formal training on the dynamics of performing social interviews for research purposes, therefore there is a risk that the researcher's skill and experience in interview process management and the application of probing techniques to solicit the desired insights were limited.

Chapter 5: Results

This chapter presents the results of the data collection process as outlined in Chapter 4 above, which is presented in alignment with the research questions posed in Chapter 3 in order to unravel what the trade-offs are, if any, in Impact Investing. This section also details the main observations for each question in order to understand the best way for practitioners to navigate the Impact Investing landscape.

5.1 Introduction

The 15 semi-structured interviews were conducted over a three month period, 13 were held face-to-face and two were conducted over the phone. An interview guide, attached as Appendix 1, was used in order to direct the respondents towards achieving the main objective of this research study, which sought to unravel the trade-offs in decision making by impact investors between impact return and financial return. The interviews were recorded with the respondents' consent and later transcribed. Content analysis was used to analyse the interviews.

The question of trade-offs questions the legitimacy of the Impact Investing strategy, therefore the respondents were each asked, as an introduction, to share their journey and their company's history in Impact Investing. This initial engagement was intended to assist the respondents to frame the paradox of Impact Investing. The probe that then followed from the initial engagement aimed to frame the respondents' impact case and finally, the respondents were directed to providing insights into the trade-offs in Impact Investing. The themes that emerged from the data were then coded and condensed. Frequency analysis was used to cluster the data and the results are presented below.

5.2 Data characteristics

The South African Impact Investing ecosystem, as a mirror of the general capital markets ecosystem, is very small and led by a few pioneering fund managers and various other managers, strategy and impact consultants and researchers working together to advance the field. Below is a breakdown of the 15 respondents interviewed for this study, based on the role each entity plays in the ecosystem.

Table 1: Sample data characteristics: Respondents by role of entity

Role of entity in the ecosystem	Number of Respondents
Fund managers	5
Other asset managers	5
Strategy and impact consultants	3
Impact Investing researchers	2
Total	15

The majority of the respondents held senior positions within their respective organisations, and had extensive experience in the Impact Investing and general finance field, some dating back to before 2007 when the term ‘Impact Investing’ was coined. The below table shows the characteristic of the respondents based on seniority within their respective organisations.

Table 2: Sample data characteristics: Respondents by role in respective company

Respondent Role in the company	Number of respondents
Chief Executive Officer / Managing Director	5
Head of Division	4
Senior Manager	5
Analyst	1
Total	15

The Impact Investing field, like the general capital markets, is not spurred by a track record requirement which is critical for attracting investors, therefore the ability of asset managers to prove success is important. The below table show the number of years that the respondents’ respective companies have been active in Impact Investing.

Table 3: Sample data characteristics: Number of years the respective companies have been active for

Role of entity	Number of respondents	Max	Average	Min
Fund Managers	5	20	9,4	5
Other Asset managers	5	22	12,8	6
Strategy and Impact Consultants	3	20	11,0	5
Impact Investing Researchers	2	11	8,0	5

When conducting the interviews, the respondents were coded with random identifier tags in order to safeguard their confidentiality. The respondents' comments or quotations included in this research report are anonymous, and are incorporated to enrich the analysis of the data.

5.3 Research question 1

What factors do impact investors consider when constructing an investment portfolio?

The respondents were asked what factors are considered when constructing an Impact Investing asset portfolio. This was done not only from the practitioners' point of view, as the consultants and researchers also provided insight based on observation. Frequency analysis was used to draw how often a theme was mentioned in the data. These were then ranked based on frequency. The results of this analysis are presented in the below table:

Table 4: Factors considered when constructing an asset portfolio

Ranking	Description	Frequency
1	Financial Risk	15
2	Impact Factor	14
3	Leadership team	7
4	Experience	6

5.3.1 Financial Risk

The respondents all agreed that the most important consideration when making an investment decision is the financial risk, which is understood as the risk of the investment failing and the investors losing the invested capital. The understanding in finance and investment is that a rational investor is risk averse, or want to be compensated for the risk taken. One of the respondents had a different view however, in terms of how risk should be viewed in the impact space, which was captured in the below comment:

“In general there's been a tendency to be overly sensitive towards risk. So people who would have been looking to give away the money in the first place and are now investing suddenly become really, really cautious which hopefully can be pushed back. I think people need to understand that actually their entire return spectrum from large high positive return to a negative hundred percent should be open, right.”

The sensitivity towards financial risk is impacted by a wide array of things, the below table lists some of the factors that the respondents highlighted.

Table 5: Factors affecting financial risk

Ranking	Risk Factor	Number of Respondents
1	Investor Profile	12
2	Finance Structure	10
3	Liquidity	9

5.3.1.1 Investor profile

The respondents identified the source of the investment capital as a big factor that affects the ability to stomach financial risk; the more risk averse your investor is, the more conservative the investment mandate would be. This view was well captured in the following comment.

- “Fund managers are really constrained by the mandate that they get from the investors. If there was money that was more comfortable with risk flowing into impact space then you would certainly find managers that are willing to go out and take some risks.”

The pension fund industry and the insurance industry are often identified as institutional investors. Institutional investors are a big driver of capital in the broad South African investment landscape, and they have been a big capital injector in Impact Investing as well. The below table shows the source of the funds managed by the asset managers interviewed.

Table 6: Source of investment capital

Ranking	Source of Funding	Number of Respondents
1	Institutional Investors	5
2	Corporates	3
3	Development Fund Institutions (DFI)	3

One of the respondents received grant funding from corporates earmarked for B-BBEE points and has been classified, in the above investor profile, as sourcing funds from Developmental Fund Institutions. Institutional investors were heavily critiqued by the respondents for being conservative, which is due to the fact that they have a legal obligation to return money to their beneficiaries at a certain point in time. The respondents also found that even though Regulation 28 has given the pension fund industry more room to allocate more funds to alternative assets like Impact Investing, they are still only contributing 1% to 3% to the alternative assets bucket. These were some of the comments that were made regarding how investors affect asset selection:

- “Different types of investors have different expectations, different risks at the time so if you are using institutional, as in pension fund money, you have far less risk appetite.”
- ‘It depends more on the investor rather than the fund manager for the most part. Fund managers are really constrained by the mandate that they get from the investors.’
- ‘We manage pension fund money, we are quite risk averse and we are mandated to invest in a developmental fund, however, they will not be very happy that we receive good developmental impact, at a subsidized level of return’

Corporate investors are not subjected to heavy regulatory requirements as institutional investors, however they require a market related, risk-adjusted return. Their mandates are normally not as specific in terms of the impact they are trying to achieve, however the respondents revealed that the corporates were looking at Black Economic Empowerment. One of the investment funds was a collection of money from corporates, where the collective investors’ objective was obtaining B-BBEEE points through enterprise development, and therefore the assets that the money could be invested in varied. Most importantly, the fund did not have to return the capital to the investors, which impacted the risk spectrum of the fund. This was the comment made by the respondent relating to the financial risk:

- “This is B-BBEEE money, we could just give it out as grants right but we’re trying to get some of the money back because that’s what we believe in and it’s also putting the mind-set of the entrepreneur to allow them to start to think in those terms as well.”

5.3.1.2 Finance structure

The issuing of debt is onerous on the investee companies as they need to prove that they are able to pay back the loan, and that will intuitively inform the type of entities that get selected, therefore the finance structure also affects sensitivity toward financial risk. Equity investments are more risky than debt investments, and the return expectation is different for both. This comment made by a respondent talks to the distinction:

- “On a risk adjusted basis, debt is more comparable with a low risk investment compared to the equity tranches which are comparable to a high-risk investment and you can then achieve higher return on those equity portions relative to the senior debt portions.”

The below table breaks down the asset managers in the respondent pool on the basis of their finance structures.

Table 7: Profile of asset managers based on finance structure

Ranking	Finance Structure	Number of respondents
1	Debt	4
2	Blended (debt and equity)	3
3	Equity	3

The South African impact space largely uses debt structuring, as that secures invested capital and the expected return, this comment captures that:

- “So if you look at some of the big fund managers in the impact space, they are managing pension money and they’re generally debt funds, meaning they have to be quiet risk averse.”

Blended means that the manager is able to use both equity and debt when structuring an investment deal. Even though the equity seems to share equally with the blended ranking, blended is highly ranked as one of the asset managers was categorised as equity even though the manager offers soft loans, however equity was a more fitting category as the manager made this comment:

- “We give it on as loans or equity and try to get it back for the next round but if it doesn’t come through we’re happy, we don’t want to then burden that person, that small business even more by asking them to, at any cost, pay that loan back or blacklist them or anything.”

The finance structuring is often also pointed to as a possible way that managers and investors can bring innovation into this space in order to mitigate risk. The respondents pointed out that the structuring done in this space is binary i.e. it is either equity or debt, but a deal can have a blend of the two. These were some of the comments that were made regarding how deals are structured:

- “It is a particularly difficult space, you have got to come up against ten million different hurdles before you are able to come up with a structure that can potentially work, and for risk mitigation purposes, you can carve up the debt in different ways so we would have senior, mezzanine, junior, equity and it is all securitization style structures where debt is prioritized on a different basis.”
- “They can’t necessarily sort of deal with having whole range of very complicated instruments but there are certain aspects that we’ve been able to do such as

preference shares for example and other you know, the mechanism of sort of seed, series A, series B and type funding which you get globally.”

- “The setting up of a fund requires a seed investor and we've done that before. We have seeded two other impact funds, so we go in as a seed investor and because we are in, then they can raise other funds.”

5.3.1.3 Liquidity

The liquidity of assets, referring to whether the assets can be on-sold (or a position exited) to other market participants, also impacts the financial risk and the investment decision. Assets listed on a stock exchange are generally more liquid than unlisted assets. The kind of assets that are seen in the impact space are normally unlisted businesses, making this space prone to illiquidity, and are therefore high risk as investors have to hold the assets until maturity. If it is an equity position, they have to hold until it makes financial sense to sell and there is a willing buyer at the asking price. The respondents stated that they take liquidity risk into account before making an investment decision. It is an input in the risk metrics and is taken into account when calculating the required return from the investment or the interest rate charged on the debt instrument. The following comments made by respondents highlight the liquidity challenge in the impact space:

- “If we're looking at an equity deal which is more risky and we only effectively get to know what our return is on exit because very few of the companies we invest in have sufficient cash flow to pay dividends. So it is just a long time to wait for the return to come back.”
- “Liquidity is like, it is a pain. If we then lend money to an entity for fifteen years to build a residential block, they are not going to be able to pay me back next year. Liquidity becomes an issue.”
- “Most of our developmental types of transactions are unlisted, then there are liquidity issues in terms of those transactions and that is something we take into account when we obviously price for risk and price for a specific asset.”

Liquidity is a function of the investment period, and as investment exits are tricky in the impact space, the investment period is normally medium to long term, this comment captures that:

- “There aren't really these exit success stories, I mean are there any? Certainly there aren't in Africa, I don't know of any social enterprise that has gone on to list on like the stock exchange for example.”

5.3.2 Impact factor

Consideration of the impact factors is unique in the asset selection process of Impact Investing. The respondents had varying impact factors, however they all agreed that it is a crucial element of Impact Investing as it determines which assets they could select for their portfolios. The respondents did not talk to a sophisticated model of integrating social factors; it was assessed in most occurrences next to the financial matrix used. The impact could be achieved in a number of ways - servicing an underserved market, the product offered is in itself impactful, there is fair treatment of all stakeholders, or through the governance structure. One of the respondents commented in relation to business and impact:

- “I think the business environment has to be fairer, as in the way we make money should not be necessarily at the detriment of others, but making money should help others at the same time.”

Impact in the sector is driven by different things. The below table lists some of the issues that were identified as driving the impact agenda within the industry:

Table 8: Factors driving the impact agenda

Ranking	Impact Driver	Number of Respondents
1	Investment Team	9
2	Investor	6
3	Regulation	4

5.3.2.1 Investment team

Some of the respondents had been in the impact space long before the term ‘Impact Investing’ was coined, and one of the questions asked was what drove and sustained the impact agenda all those years. Most of the respondents agreed that the big driver of impact is having the right team. Impact Investing is new and unconventional, and therefore respondents faced challenges not only in terms of raising capital, but also with limitations in the asset selection, as funds can only be disbursed in certain sectors and at times it is difficult to find good investment opportunities. It is the team that navigates the landscape and finds innovative ways to mitigate risk. The respondents acknowledged that Impact Investing could have been started or introduced by an individual with strong leadership capabilities as well as strong moral convictions and determination to invest with an impact lens. Some of the institutions had a strong Impact Investing history, having being formed for a purely developmental purpose. Below are some of the comments made regarding this issue:

- “I think most of the people I work with all acknowledge how difficult this space is, but we are fulfilled by the fact that it is not entirely capitalist, It is developmental. It is also delivering the commercial return that is very much making sure that we are making a difference.”
- “I think what makes a big difference in our organisation is that there is an alignment of vision among the leadership. So understanding the importance of sustaining the skills development and contributing towards the transformation of the profession.”
- “We are a small team and, look there will always be because it was founded by one person, there will always be that culture that is more dominant, but I think the rest of the team’s personalities and values come through in the decisions we make.”

What was also noted was the origin of the of impact lens. Some of the asset managers were stand-alone impact funds, whereas others were a unit in a previously purely profit driven investment company. There was no notable difference however, in terms of the culture of the unit being negatively affected by the overall profit driven culture of the company. One of the respondents from a unit in a previously purely profit driven investment organisation stated that:

- “The people that are involved here, understand what passion is about, we understand what our client wants and urge for this type of investment. We have lots of factors that contributes to why internally we have a strong energy for these types of investments.”

Recruitment

The respondents agreed that the right team is a critical success factor in Impact Investing, therefore it is important to attract the right people from the onset. This is driven by the company messaging and positioning in the market, as professionals might have to take pay-cuts as the space is not as lucrative. The right people drive the values that can sustain the impact lens, and examples were provided of companies working in this space getting many requests for employment due to how they positioned themselves, despite not offering market related compensation. The original intake in the impact space was mainly purely finance professionals, which was good in terms of the adoption of best practice tools, but as one respondent noted it could also limit creativity, hence the process of investing in many instances mirrored what was being done in the conventional, purely finance space.

When asked if there is anything in particular that they look for when recruiting to ensure the stability and sustainability of the culture, these were some of the responses:

- “It is just being able to identify the right person who is up to the challenge of navigating a difficult landscape and has the appropriate finance, property, legal like self-starter skills to be able to get through challenges that we face here.”

- “I think some of the funds, working in this space are pretty good at attracting people that have an interest in having a social impact as long as that’s foregrounded in the company’s messaging. I actually think, provided your company messaging is strong enough you actually have an advantage in attracting people that have those values and are willing to come in at salaries that are probably below what they could get elsewhere in the market.”
- “So I think a lot of that does go to the selection process. We have to make sure that you can recruit correctly. I think, you know, we’re very clear about what type of fund we are and within the social impact space there are some trade-offs that even the investment professionals need to make in terms of its possibly not as lucrative as other areas. But we feel that it brings other type of rewards that are deeply satisfying from a personal perspective and I supposed each individual needs to assess that when they join.”

5.3.2.2 *Investor motives*

Instituting impact in an investment firm requires an investor with a similar mind-set and strong values. This will ensure adherence to the impact agenda, as it acts as an inherent control to ensure the manager does not drift from the impact mandates. The manager would need to prove to the investors how they are achieving the said impact, as well as making risk-adjusted returns. The big risk is thus using the wrong kind of capital in Impact Investing, as investor demands could cause tension in decision making. These were some of the comments made by the respondents:

- “You have pots of money within the investment industry which are only made available for certain things, the project money that we have to manage is made available for Impact Investing.”
- “Given the funding that we have received, our impact is actually in job creation. That’s how we articulate impact and that’s what we measure very closely and the lens through which we evaluate potential investment opportunities.”
- “We started off by investing in unlisted businesses operating in an environment that is capital intensive, needing cash injection with some initial funding we had from our seed investors, however, from an institutional investors’ point of view, it is a pretty hard sell.”

5.3.2.3 *Regulation*

The Pension Fund Act increased the allocation of pension fund assets to alternative assets from 5% to 10%, and impact investments assets often fall under this classification. However, what was found in the industry is that the reform was disappointing as the institutional investors were found to still be contributing an insignificant amount to Impact Investing. The enterprise

development required of corporates in terms of the new B-BBEE codes was also found to have influenced some of the growth in the sector. The tax legislation regarding the taxation of returns made in venture capital companies has also been amended, allowing for 40% of the return to be tax exempt, however this is a new development and it needs more time to see if it results in more money in Impact Investing. The following comments were made in terms of regulation and impact:

- “I think the corporate sector is tied by the B-BBEE regulation and as long as that is tight then they can now start thinking about impact.”
- “If you are a tax paying entity it's almost like they reluctantly go this route, they invest in impact funds because they get the equity points, they do it reluctantly, but they do it because they get points, it's almost like a requirement.”
- “There are other regulations that are not exactly for impact investments that have opened some doors for impact investment such as the Section 12J Venture Capital companies because that encourages more angel investors to put money in those types of funds.”
- “Even with those limits changing in terms of Regulation 28 we probably have more funds going in and increasing the exposure but still as a total of the overall fund allocation, it is still very small.”

5.3.2.4 *Other impact elements*

Defining impact

A differentiating factor of Impact Investing is not only that impact is a goal, but it also needs to be measurable, and the only way it can be measured is if it is well articulated and defined. Some of the respondents defined their impact as follows:

- “We first need a fundamental understanding of how businesses work, and secondly see that if they are really beneficial to the society, but in terms of where we are hunting for the businesses, what kind of businesses we are hunting for, it is in the area of social upliftment and environmental impact.”
- “Because of the nature of South Africa around there are some areas which are underserved and we needed a big infrastructure rollout, we thought of an investment opportunity and also an opportunity for us as a fund to be able to support and grow the country and boost economic and social development.”

Integration of impact

The respondents were then asked about the process followed in making an investment decision, specifically how socio-environmental factors were considered in decision making. One case that stood out was where consultants were contracted to review the ‘Impact Case’ of every asset as part of the due diligence process, and participated in deciding whether the investment should be made from a social perspective, whereas the manager decided from a financial point of view. On discussing the investment process, these were some of the comments:

- “The fundamentals of finance kind of remains, because we are dealing with people’s money and then add the social impact factor to the equation.”
- “Impact Investing, to me, is as simple as just add one more criteria to your investment metrics. That’s it. You’re done.”

In understanding if the Impact Case can actually affect the investment decision, it is important to understand when in the investment process it is assessed. For many of the managers, the process starts with the identification of an impact asset, and then using a risk matrix once the impact case has been proven to weed out financial risk. The timing of impact consideration is driven mainly by how impact is defined. The asset managers with specific mandates get to consider only assets aimed at an impact area, therefore impact is considered prior to risk assessment procedures. The managers with a broad mandate would assess a broad range of assets and develop both the impact and business cases during the risk assessment process. The following table shows the respondents’ views on the timing of when the impact case should be considered:

Table 9: Timing of the assessment of the Impact case

Ranking	Timing	Number of respondents
1	Prior to business case	9
2	Risk assessment	7
3	Post business case	2

5.3.3 Leadership team

The leadership of the target companies is seen as a critical factor in ensuring the success of the company, and therefore of the investment. One of the respondents captured this by stating that:

- “When you invest, you give the money to the company. You’re not there running the business every day. There are people who run those businesses, there are people who know so much more about that sector. Let them do their stuff.”

For another respondent, the target leadership is seen as a partner, as the investment management is a corroborative effort of the investor and the management as stated in this comment:

- “The way we invest is very much on a partnership basis. So, we are the financier but we also take equity stake in all of our investments. So the reason we do that is effectively because we are partnering with someone who has experience.”

Another respondent identified their organisation as a ‘character-based lending organisation’, which was explained as:

- “Usually a loan is issued into a juristic entity (a company), but it’s the people that run the company, so we want to know who the directors or shareholders are and whether they will act responsibly.”

5.3.3.1 *Value alignment*

It is important for the success of the investment relationship that the values of the investor and the leadership team are aligned. These were some of the comments that talked to this aspect:

- “I think our biggest differentiator is in our value alignment. I mean we have had instances where we walked away from transactions purely because we were not convinced of the ethical values of the potential partners and I think that was a significant transaction.”
- “There are certain companies where sometimes we can’t invest even though the company is doing well because the people behind it are against what we believe in, they just don’t fit in line with what we are doing.”
- “So I think we definitely feel that culture and values and the mission is a critical part or how well those are defined is a critical part for success as well. So that everyone’s pulling in the same direction.”

5.3.4 *Experience*

The respondents, when discussing what they look for in target companies, said that one of the things they look for is a track record, to show that the target knows the sector and has had some form of success in the form of financial growth or in identifying opportunities for growth, and are now looking to scale.

5.3.4.1 Investment size

The experience will also be a factor of how big the investment cheque is, for example it is highly unlikely that an investor will write a big cheque for a start-up company needing seed funding. One of the respondents with high risk tolerance chose to invest in start-ups, with an investment size ranging from R50 000 to R1 million. When asked whether the size of the entity matters in making an investment decision, one of the respondents stated that:

- “Size does matter, and it is driven by how big the funds are but also what the requirements of the funders are.”

The following table looks at the minimum investment sizes of the respondents, as it informs the size of the entities that they invest in.

Table 10: Respondents’ profiles based on investment size

Ranking	Investment Size	Minimum Investment	Number of Respondents
1	Green-field	10 000 000,00	4
2	Large	50 000 000,00	3
3	Scale-up	500 000,00	2
4	Seed	50 000,00	1

It was also found that the profiles of one’s investors greatly affected the investment size, the large investors, like institutional investors, have big minimum investment sizes. This influences the asset selection as one will only be able to focus on medium to large entities. These were the comments made in respect of this:

- “If you are using pension fund money, inherently, you are looking for very big investments, you don’t want to be investing in things like social enterprises.”
- “In South Africa most of the money comes from pension funds and it’s mostly sitting in debt funds, in fixed income funds, which means you’ve got relatively big funds but they’re making relatively big investments.”
- “Actually, I think there is quite a large availability of capital in the market at the moment. What is difficult is to find the right type of deals with the right capital so it’s very much a matching exercise and possibly where South Africa is falling a bit short is in the seed funding.”

5.3.4.2 Deal costs

The respondents mentioned the costs of processing a deal as a big driver of why their deal sizes have to be big. The investors, especially lenders, borrow at a certain rate or need to pay a specific return to their own investors, and the difference between that and what they gain

from the client is what they must survive on; it is the fund manager's profit in a sense. These were some of the comments made in respect of the costs as an element of investment size:

- “It just becomes too small to justify the amount of work that comes from our side. So from an investment perspective you need to run full due diligence, you have legal team, you have group internal audits so there is quite a lot of financial overlaid costs on our side where we need to achieve deals on a certain scale before we can do them.”
- “We need to keep our businesses standard, whatever our cost may be, and we start doing bigger size deals just to make the economics work on our side.”
- “We are refining from a value perspective, what value type transactions will be looking at specifically, if it is a small one with easy process and very minimal effort we will not turn it away, but I think part of the school's fees we have paid over time is that, it actually takes just as much time to close the small transactions as the big transactions. Our aim in the short, medium, long term is to look at more punchy transactions.”

5.3.4.3 Pipeline

The above highlights the significant gap in seed funding, which ultimately results in pipeline issues for the investors. This issue was emphasised by the comments made by the consultants and researchers in the impact space:

- “If you're talking to some of these big fund managers, they have a lot of the exact same companies sitting in their portfolios.”
- “It's interesting to hear the managers talk about how they have different mandates or investment approaches, whereas they all end up investing in pretty much the same investee.”

One of the large managers with a minimum investment size of R150 million admitted to having pipeline issues in a certain sector due to the high investment size, however the way to get around it is finding businesses working in several developments that add up to make it financially sound. Another respondent elaborated by stating that:

- “If there are all these big fund managers that invest in all these large deals, who's actually developing that pipeline when the businesses only need R2 million or R5 million? They can work in the higher end of the spectrum, they themselves have pipeline challenges because no one is willing to do the business development that is needed for the businesses to actually get to that scale.”

To overcome this challenge, the investor looking at seed investments has invested in a business accelerator and sits on the Board in order to assist with strategy formulation, and hopes that the accelerator will then assist with pipeline development and risk mitigation as the

business will have already been assessed and assisted by the accelerator. However, even with investors like these there is still a gap for seed funding, because start-ups are perceived to be inherently risky.

5.4 Research question 2

What are the trade-offs (or impending risks) of Impact Investing? This refers to both financial and non-financial risks.

The respondents were asked if there are trade-offs in Impact Investing, resulting in the funds making lower than market returns. The responses were analysed and the recurring themes are tabled below in order of frequency.

Table 11: Factors causing trade-offs in Impact Investing

Ranking	Trade-off factor	Number of Respondents
1	Return expectation	13
2	Operating Environment	13
3	Impact Factor	7
4	Fund Structure	6

5.4.1 Return expectation

The respondents were asked if they had return expectations, and whether those were market related. The asset managers revealed that the funds could be managed at a portfolio level, and therefore the expectation would be fixed for the portfolio. At a deal level, however, the assets would be managed based on where the performance of the fund is and if the asset returns needed to be adjusted in order to achieve portfolio level returns. None of the respondents felt that the expectation should be above market returns by virtue of the asset having impact. In fact, some alluded to possibly adjusting the return expectation down in order to have high impact. Only two of the asset managers had impact targets at a portfolio level, whereas the others assessed impact on a deal-by-deal basis. This was the explanation given by one of the respondents relating to return management when building a portfolio:

- “Normally when you construct a portfolio you start building with the net risks and assets first. And then you start adding low cost risks. So that the earlier stage of the fund, you are not in the likes of making massive returns, because you are only going to add the household opportunities later on. But you are not going to lose money either in the early stage of the fund. You might get it wrong, if you make a bad investment upfront then you have nothing to shield a return. You are then building a portfolio up backwards. Like having twenty assets. If one asset goes bad but then you still have

other nineteen still performing, shielding the return. But if you do the small risk upfront, and it does flop up, your whole entire fund becomes non-functional.”

Specifically considering their impact, which is job creation, this manager agreed with the above comment by stating that:

- When we started the fund, the jobs were very much a key focus and we managed to do some very high job creating deals up front. So that has allowed us to sort of slightly broaden the reach to potentially look at more financial return deals because as things stand at the moment we are pretty much on track to meet our job creation targets.”

It is thus clear from the comments made that when returns are managed at a portfolio level, a deal could possibly focus more on impact or more on financial returns, alluding to some form of a trade-off at deal level. The following table lists the responses to the question of return expectations:

Table 12: Return expectation

Ranking	Return expectation	Number of Respondents
1	Market related return	8
2	Deal by deal basis	5
3	Capital preservation	3

5.4.1.1 Market related returns

The question of return expectation is fundamental in Impact Investing, as the returns are as important as impact. Most had market related return expectations due to the fact that economic stability ensures the overall sustainability of the fund for two reasons:

- The investments returns, which are inflation and risk adjusted, can revolve and enable the company to continue investing.
- The ability to prove to investors how you have managed to create wealth in the form of investment returns will enable the managers to raise new funds and continue investing.

These were some of the comments made relating to return expectations:

- “I do agree that it should not be at the cost of the other, because ultimately in order for one to have that impact in terms of community development or professional or skills development there must be resources and the biggest resource is usually financial and

so you can't do that if there is a discounting element in terms of the commercial vehicle which drives that financial growth.”

- “So if you are investing in this asset class your expectation is, you will get a slightly higher risk adjusted return and unless you can achieve that you cannot in good faith put someone else's money into these investments.”
- “As long as the economic return – well, the economic return needs to dominate because it needs to be able to endure. If you make the social outweigh the commercial you're going to end up in trouble, unless you are purely philanthropic; even there you've got to have outcomes otherwise you won't get funding into your NGO.”

5.4.1.2 *Deal by deal basis*

The portfolio could be management such that the financial and impact returns are fixed at portfolio level, however on a deal by deal basis, one of the objectives could possibly dominate. A respondent stressed that this is especially true in their fund, by commenting that:

- “We hold the two intact, in sort of balance and we understand now that you can't necessarily get both in one deal. So we try obviously, that would be fantastic, but we sort of subsidise one for the other depending on the sort of view.”

Other respondents stated that:

- “I think if they can benchmark themselves to their peers who are working in a similar investment sector they should. There are certain sectors in which I think you can't get the market rate returns, and that's fine but know that you are going for that, like be explicit about the fact that you are prioritising something else and not the financial return and that's okay.”
- “So the expectation on the mandate is capital preservation plus a certain amount of return but it's relative, it's not that demanding over all, from a portfolio perspective but in this space one has to appreciate that some of the investments will fail, it's a reality. So in other words. If one is going to fail for the others, so you have to set your expectations much higher than what you wanting to deliver on a portfolio basis.”

5.4.1.3 *Capital preservation*

The respondents highlighted that the market is dynamic; some investors aim just to preserve their capital, and there are grant funds which also give room to managers to participate in high risk investments where they can lose the money while pursuing Impact. Three of the managers were aiming for just capital preservation, which was purely driven by the fact that one was financed by a Developmental Finance Institution and one relied on grant funding from

corporates earmarked for B-BBEE points. These are some of the comments the respondents made in terms of capital preservation:

- “I think that when you are doing the early stage seed stuff there is a space for venture philanthropy, what we are trying to do is get to the point where we don’t necessarily make a huge return but we would like to not cannibalise all of our capital.”
- “As a company, we would like to earn prime minus two as our lowest return, but we are currently not as we are now getting prime minus four, but it comes with a 100% capital guarantee. If I didn’t have that we wouldn’t do it.”

5.4.2 Operating environment

The operating environment affects the structural setting not only of the investment firm, but of the entire ecosystem. It could thus be an enabler or a hindrance in the development of the Impact Investing ecosystem. The respondents, when discussing the challenges faced in the operating environment, mentioned various themes. The below table shows the themes that were identified, ranked based on frequency.

Table 13: Operating environment factors

Ranking	Operating environment factors	Number of respondents
1	Regulation and Policy	13
2	Government	7
3	Macro-economic environment	6

5.4.2.1 Regulation and policy

There is no doubt that regulations can be effective in driving capital into Impact Investing, however regulation has been topical in the impact space in the sense of creating a new legal hybrid structure that social enterprises can identify with, reporting requirements on companies’ impact, asset allocation by pension funds, and the legislation around B-BBEEE. The respondents who commented on the legal structure issue were torn, as some do not believe that a hybrid structure is necessary. There are also studies in the area on how regulation can be used to catalyse the growth of the sector, such as possible tax incentives for investors in the likes of Section 12J. At the investee level, there are some levers that they can take advantage of as small businesses or non-profit organisations. These were some of the comments made with regards to regulation and policy, which cause friction in Impact Investing:

- “One point to make on government’s role around pension funds. As a fund, we don’t believe that government should prescribe to pension funds as that is not the mandate

of government. Pension fund members should have the choice whether they want to invest in impact, developmental type of transactions or not, so even in past few years there's been an issue around government's prescription coming about and prescription in the extent that government is going to basically force pension money to be allocated whether they like it or not to the sector, we don't believe that's the right thing."

- "I think people can very well start hybrid structures and have Trusts and other ways that could mimic social enterprise structures. I just think that at the level where we are at for social entrepreneurship, I don't think a new legal structure would change that much but maybe I just don't understand the construct."
- "I mean I think there are other areas where there's a possibility for regulation to play a role. Things like a separate business registration for social enterprises and so on, just to provide some clarity to the market. Investors hate uncertainty, so when you're talking about what is a social enterprise and there's no clear legal framework, no clear structure that turns to put them off."

5.4.2.2 Government

In the National Developmental Plan (NDP), the South African government acknowledged the need for social development and has embarked on initiatives in an effort to crowd-in investment. The respondents acknowledged some of the successes the government has had, such as the introduction of the Independent Power Producers (IPPs) in renewable energy, however concerns were raised regarding the effectiveness of the government offices that the investee companies deal with. The respondents also stated that the delays encountered by investees affect their margins. Government-issued grants were further identified as a possible avenue that impact investors could use in their fund structures as first loss or seed funding in order to mitigate risk. These were some of the comments made regarding government initiatives in driving impact:

- "So we are aligned with the government developmental goals, and government has identified infrastructure as a big area of development where they put lots of money in, so that's one example. We are not obliged to do it but in a lot of cases, when the return is good we will participate with government in those type of projects as an institutional investor. We are supporting government's mandate, in infrastructure rollout and job creation and obviously that will result in economic benefit."
- "The government can be a big help or they can be a huge hindrance, they were a huge impediment and hindrance with the new Greenfield developments; documents would get lost, we knew that there were letters sitting on desks waiting for some sort of bribe to be paid before they were signed, the delays were unbelievable."

- “When the new government came in 1994, it was the usual thing with the government saying it will deliver. So they start competing with the private sector which crowds out the private sector.”
- “I think it’s, you know, government could potentially promote the seed funding, early stage innovation investment, which they do already to a certain extent. It’s just how much of a priority and how much of resources are committed to it. Then there’s obviously making it easier for investors but equally and providing a more entrepreneurial friendly landscape for the SMEs.”

5.4.2.3 *Macro-economic factors*

South Africa is an emerging/frontier market and therefore faces many developmental issues, most notable of which are low standards of education, poor access to quality health care, aging infrastructure, therefore there is a real need for impact investments. These challenges are also an opportunity because there is an underserved market where an impact lens could drive high financial returns, however the lack of infrastructure could also make an investment very costly. The market has many emerging, small scale businesses with impact lenses in terms of economic growth and job creation, however these have been identified as ‘inherently risky’. Some respondents are focussed on specific areas where they are making returns and generating impact. Notably, the country has a world class banking sector and the Financial Sector Charter has contributed to driving Impact Investing.

- “The Financial Sector Charter, from 2006 through 2008, was encouraging the banking sector to increasingly lend and make finance more available to the low income, affordable sector of the market.”
- “I think inherently in this space is risky because the ability for SMEs to withstand external pressures is very thin. They don’t have the buffer and the resources like bigger corporates have to withstand some of the variables that are thrown at them in terms of, you know potentially a customer paying them late to get them cash flow or suppliers not delivering etc.”

5.4.3 Fund structure

The fund structure came out as one of the factors that could impact whether a trade-off could exist, where one objective, either financial or impact, dominates and directs investment decision making. Legal entity was identified from the interviews as an element of the fund structure.

5.4.3.1 Legal structure

The majority of the respondents who managed assets had a for-profit legal structure. The following table is a profile of the ten asset managers in terms of their legal structure:

Table 14: Legal structure of asset managers

Ranking	Legal structure	Number of Respondents
1	For-profit	8
2	Non-profit	1
2	Hybrid	1

5.4.3.1.1 For-profit structure

A for-profit structure not only means that the manager is managing the clients' money, but that he also has shareholders that he needs to account to. It is thus important to maximise the investment return, especially if the fee structure, like conventional funds, has a management fee and a performance fee as profit drivers for the fund.

- A management fee is the fee deducted upfront as a percentage rate of assets under management, which the manager uses to cover the costs of running the investment fund.
- The performance fee is the fee charged when the fund performs above the expected return.

The management fee will therefore affect the manager's drive to increase the assets under management, whereas the performance fee will affect the manager's drive to achieve above market risk-adjusted returns. These were some of the comments:

- "If your fund structure or your performance structure is no different from any other fund where you've got management fee and then a performance fee. I think that's going to drive the decision making and that means sacrificing some social impact to make sure that you get some financial returns, you're going to do that. One of the things that will change that is if you have very hard targets."
- "We need to come and justify the fees that we charge because this is not a massively lucrative business. We have been making our returns, which allows our investors to follow us on the one side, but we also need to make fees for the business, which is the manager of the fund. You need to kind of meet everybody's requirements along the chain. That is the challenging part."

The impact management fund is a social enterprise, which, as one of the respondents commented, should be profit making, otherwise it does not make financial sense to continue managing funds:

- “You have to find a way to actually make an impact and make money, if you don’t find a way then why do you exist? A lot of impact businesses are run by people who think; how can I change the world and this would be a good idea to change the world but you can’t run a business without knowing how to make money with it.”

5.4.3.1.2 Hybrid structure

A hybrid is formed with the registration of a non-profit and a for-profit, with the non-profit holding a certain shareholding in the commercial vehicle. This kind of structure is formed in part to create a sustainable model for the non-profit. The commercial vehicle is conventional and the fund earns revenues.

- “So we have got varying revenue streams that is one line that is greatly under focused from a growth perspective and there is a lot of work that needs to be done there but at the moment we gain management fees from some of the investing companies. We have dividend flows that are coming from one of our incumbent assets. We also get a board fee from participating at board level in investee companies. So those are the key three revenue streams at the moment.”

Therefore, based on the above comment, the profit structure for the hybrid is similar to the for-profit model.

5.4.3.1.3 Non-profit structure

A non-profit company does not have shareholders and receives its seed funding from development fund institutions and the money could be revolving for years. The risk appetite of a non-profit is slightly higher than most Impact Investing funds, as the company aim for capital preservation and not market returns. Furthermore, as a non-profit, the organisation is not subject to tax.

- “So I'm not answering to shareholders, as long as we remain solvent and make some money and don't lose too much money we are doing ok.”

5.4.4 Impact factor

In trying to ascertain what the trade-offs are in Impact Investing, the respondents were asked about the legitimacy of pursuing hybrid goals, specifically if the addition of the impact factor in

decision making is sustainable. The below table show the different views of the respondents to a question of ‘are there trade-offs in Impact Investing’:

Table 15: Trades-off in Impact Investing

Ranking	Are there trade-offs in Impact Investing	Number of Respondents
1	Yes, there are trade-offs	8
2	There are perceived trade-offs	4
3	There are no trade-offs	3

5.4.4.1 *There are trade-offs*

The overwhelming majority of the respondents believed that, due to the financial risk (mainly liquidity), there are trade-offs in Impact Investing. The impact lens has limited the transactions that the managers can look at; in some cases it has forced them to walk away from transactions that proved to be financially sound, yet as there was no impact case or there was a concern over the values, they could not close. This has resulted in increased risk due to a lack of diversification and concentration exposure to certain companies or sectors. This could be the reason, as some of the respondents alluded to, that the big impact funds end up investing in the same companies.

- “There is a mantra that says if you invest in social impact you won't get anything less than what you normally would, it's not entirely true. It's a nice idea because what you trying to do is, I'm now looking at agricultural impact, I'm going to get what I get in the market linked account say 6.5% return for my money, but I'm taking a risk because I'm actually making an investment.”
- “I think almost by definition that you could have a greater social impact if you had a smaller profit. I think it doesn't mean you can't have social impact while making a financial return. But I think we'd be fooling ourselves if we thought that there no trade-offs and I actually think that it might be quite damaging to keep banging this drum.”
- “We have job creation targets that we need to make and we also have financial return targets, that we trying to match. So that's you know, when you hear of sort of double bottom line, that is what that means. We hold the two intact, in sort of balance and we understand now that you can't necessarily get both in one deal. We sort of subsidise one for the other.”

In knowing and understanding that there are trade-offs in Impact Investing, some respondents discussed that the market is dynamic, that there are different types of investors, that some investors are actually ok with the trade-offs, and that their primary objective is making an impact. The alternative is that there should be an alignment between the investor, the manager

and the social enterprise, with the understanding that the risk is very high and that the capital may be lost. This understanding created a school of thought in the investment space, where investors are categorized as either impact first or return first. These are some of the comments:

- “When we assess risk we look at the financial criteria the way we would look at a non-developmental transaction. Remember return comes first for us, the impact is secondary.”
- “Some investors are called impact first investors so they prioritize impact over returns, meaning they might make a decision to pursue a strategy for the business that actually creates ten times more impact but two percent less returns. Whereas there are some fund managers or some investors who are more kind of finance first focused, the impact is really important to them but they focused on the financial returns better.”
- “The market is more dynamic than that and some investors are okay with a trade-off. Some investors just want capital preservation, they just want their money back, they are not looking for big profits. And at the other end of the scale, there are people who really don’t care about social impact and only want profits.”

5.4.4.1.1 Mission drift

The respondents stated that the trade-offs normally cause what is called a ‘mission drift’, which is the risk that the investee companies will end up negating the impact factor while pursuing the financial returns. The mission drift could result from increasing product prices, changing the market served, changes in the governance structure, or changes in how one does business. One of the respondents stated that not all social enterprises have the same risks, however perhaps the universal risk in Impact Investing is mission drift. The risk of the investee company drifting can be mitigated by contractual mission lock and/or by integrating impact into the business activities.

- “I don’t think that there are risks that are across social businesses that are consistent. One risk, if you want to call it a risk, is if your impact business experiences mission drift that could be a risk. At some point, the management of the company is changing its social mission and starts making decisions that go against their long-term goals, that’s a risk you don’t have in a non-social business, but other than that, it depends what industry you are in.”
- “By trying to basically juggle these two competing objectives, sometimes in some businesses there comes a point maybe when the business is scaling it is more profitable for them to serve a different market right, and so then the profit objective and the impact objectives are clashing. So what happens when those two are competing so that in itself is obviously is a very unique risk for impact investors, I would say it’s

actually the biggest one and the one that probably causes people to have this perception that there's a trade-off because they think that at some point that probably happens with the businesses.”

- “I don't think all social business experience mission drift, as some of them, the impact is so integral with their business model that, like they go together. So the business becomes more profitable by actually serving that specific market [underserved or low-income market] because that's what they are good at.”

5.4.4.2 *Perception of trade-offs*

Some of the respondents stated that the trade-offs are actually just perceived and not factual, as there are ample case studies that prove that one can get maximum return while also pursuing impact. It could be that the market is confused as there are different types of investors all with different objectives, and some are happy sacrificing financial returns for impact, but that is not always the case. These were some of the comments made in respect of the perception of trade-offs:

- “A lot of people need to change perception and this happens in the start-up environment, it is not only in Impact Investing or social enterprise space and so the is a perception that, these types of entities are apparently risky but actually there are things that you can do to mitigate that.”
- “People perceive trade-offs, well it's mental laziness that makes people who have never thought about their social impact need to say that ‘actually I can't do that while also making money’. It's mental laziness.”
- “There is still that perception amongst investors that there are trade-offs, but there have been several studies done to show that that is not necessarily the case.”

5.4.4.3 *There are no trade-offs*

These respondents thought that there are no trade-offs, as there are several case studies about very profitable entities with an impact lens. The respondents said the misconception that there is an opportunity costs with pursuing investments with an impact factor, whereby the investors could be losing out on above market returns elsewhere in the market is unfounded, and that actually the lack of an impact factor threatens the sustainability of the company, increasing investment risk. Some of the respondents gave examples of profitable entities that have managed to integrate impact into their business activities. They argued that an enterprise cannot exist outside of its environment.

- “I'm saying that the idea of a business is to be responsible and it is responsible to not only its employees, but to all its clients. The impact it has by servicing its clients or by

producing a product over - that effect is needed if you want your business to continue. It is needed, there is no other way but to do it in a social way. The idea of breaking even as a goal, is absurd. You don't have a business, you not going to grow, you won't be able to do anything. Breaking-even cannot be a goal. The bottom line is you need to make profit."

- "I do agree that it should not be at the cost of the other, because ultimately in order for one to have that impact in terms of community development or professional or skills development there must be resources and the biggest resource is usually financial and so you can't do that if there is a discounting element in terms of the commercial vehicle which drives that financial growth."
- "There's often ample opportunity to have impact and derive good financial returns if you're really focused on the needs of the community you're working in, and so very often in our work with development finance institutions or with certain kinds of impact investors we would say 'look, actually you can have a lot of impact within a purely commercial investment, by trying to pursue positive impact across various aspects of the value chain'."

5.5 Research question 3

How do impact investors achieve the balance between the competing logics of profit maximisation and socio-environmental Impact?

Achieving a balance between these seemingly competing objectives can be very difficult, therefore the respondents were asked how they attain a balance between generating impact, maximising financial returns, and creating wealth for the investors. The respondents' responses were analysed, and the themes that were identified are listed in the table below:

Table 16: Factors considered in balancing competing logics

Ranking	How can a balance be achieved	Number of respondents
1	Legal contract	13
2	Risk assessment procedure	12
3	Finance structure	10
4	Impact values alignment	8
5	Investment approach	6
6	Leadership team	6
7	Millennial push	5
8	Development of case studies	4

5.5.1 Legal contract

The impact investors look to the contractual agreement in order to articulate what they want. This ranges from return expectations to securities (if there are any), mission lock, reporting requirements, etc. In the impact space, the contractual agreement plays a big role in ensuring that mission drift does not occur in the investee company during the investment period. Furthermore, as all the impact is happening at the investee level, the contract will also articulate the impact that should be measured and the reporting requirements. Below are some of the comments the respondents made in regards to contracting:

- “So I think we have learned that the biggest hurdle is identifying the risk, and that the most important thing is that the agreement close those loopholes so that your interests are covered. We work very closely with our legal adviser in fact from the initial stages of our transactions all the way through, any document gets reviewed.”
- “We write it into the business, the agreements that we have with the businesses to make sure that they are not mission drifted or their mission drifts. Then we say that they need to report to us, but we take this as part of our normal risks management strategies.”
- “It is a very difficult thing to mitigate risk because it can be written into the constitution of the business, but if nobody enforces that constitution then there is nothing you can do about that.”

5.5.2 Risk Assessment procedure

The risk assessment procedure in itself could be seen as a form of risk mitigation, as the more rigorous and detailed the process, the better and more appropriate the tools are that can be used to mitigate the risk at the investee level. The respondents discussed various due diligence tools used to assess risk, such as credit risk or investment committee, risk matrix, impact case development, liquidity and solvency ratios, etc. These were some of the comments made regarding the risk assessment process:

- “So we would work very closely with our managers because normally the due diligence that they do turns up areas of business risk in their portfolio companies, so they generally have done the work to understand where the risks lie in those companies and then we work with them to design interventions that will soften those risks.”
- “By the time the deal’s been through our credit committee and we’ve put six pairs of knowledgeable eyes going through the deal, we’ve probably weeded out most of the risk with our combined networks of who we know and the questions we need to ask. We can normally pick up most times whether or not this person is going to be a good

vehicle through which the investment will succeed, not a vehicle but the brains that run the project.”

- “When we do our due diligence and one of the things we will pick up, the people thing is very important, and not just the people from the management perspective but the people in the organisation. You look at things like, what is the relationship with the workers? Are there strikes every other year because then that clearly then tells something about the way the business is being managed. Are people leaving every other two days? That tells you about the management team you’ve got in place.”

5.5.3 Finance structure

The finance structure could be used innovatively to mitigate risk, however the view in the market is that it is quite binary and boring as managers are currently only using equity and debt, however there are managers also adopting best practice finance structures from the conventional equity and debt markets. There is also talk about using profit or revenue sharing structures so as not to overwhelm the investee companies with cash-flow shortages. These were some of the comments made with regards to innovation in the impact space:

- “There’s some interesting ideas that are coming out, but in terms of financial structure, I don’t think people are doing anything all that different with the exception of maybe organisations in enterprise development, which are doing things slightly differently.”
- “There’s way too much money standing at the entrances, confused about what the opportunities are and unable to be wrought into meaningful uses and until you come up with instruments and structures and products that really can absorb capital at scale in a non-linear way, you’re always going to be struggling.”
- “There’s kind of amazing things happening all over the world, there’s innovative things, there’s things being tested there’s lots there’s more and more evidence I think being built which is great because that just makes people more comfortable.”

The discussions in terms of the finance structure centred on these three elements:

- Pricing
- Collateral
- Guarantees

5.5.3.1 Pricing

The fundamental finance principles compensate the investor for taking high risk with a high return. The risk matrix generally models risk-adjusted returns, therefore the price charged on a debt financing deal or the return expected on an equity deal is seen as a form of risk

mitigation, as it compensates the investor for taking the risk. This principle has been used for a very long time, however a critique, especially in the small business and social enterprise space, is that requiring high interest rates from these business is negatively impacting on their cash flow and increasing the probability of failure. Some of the respondents do adjust their price or return expectations depending on the risk.

- “We would follow the same credit process the way we would do on our non-developmental funds and apply that and ensure the due diligence as well as the environmental, social and governance due diligence in terms of our analysis process. It is the thinking around managing risk or identifying risk would be exactly the same in a non-developmental portfolio and a developmental portfolio.”
- “Contrary to most people, I don’t believe that raising the interest rates will actually mitigate the risk, I think it puts more pressure on the borrower and actually increases the risk.”
- “We do hope to structure our investments in the most efficient way to ensure that the investees have the correct amount of capital available to them within reason to meet the demands of their growth path, so that they’re not kept short and these cash flow issues come at them very quickly.”

5.5.3.2 *Collateral*

Physical assets are less risky as they can stand as security, which could be repossessed should the company be unable to make the debt repayments. Collateral reduces the risk profile of the transaction and thereby reduces the price of debt.

- “Our money is secured against the asset and we look to the asset to repay our loan, unlike a home loan where you’re actually looking to the individual to get a job and pay the bond back. We’re looking at the net rental income collected from the building to pay our loan.”
- “If, for example, a debt investment reaches the level of being, you know given the securities and the collateral and whatever we are able to get through the debt structure then maybe we’re looking at a lower IRR (Internal Rate of Return).”

5.5.3.3 *Guarantees*

Guarantees can be used in the financial structure to provide security to the investors; should the company or individuals not be able to pay back a loan, then usually a Development Finance Institution (DFI) referred to as a guarantor would step in and pay the debt to a lender. The guarantees from DFIs can also be used as first loss capital, providing a cushion for investors and making them comfortable investing in a certain fund or project. Yet the

respondents thought that even though they could be used in innovative ways to reduce risk, the market is sceptical of them due to the fact that sometimes they are not structured attractively or the conditions of the guarantees are too strenuous on the fund manager. These are some of the comments from the respondents:

- “The fund managers are being clever because there is a lot of ground funding in South Africa for different things, they are being clever by using that ground funding to de-risk their investments so that their investors actually feel a lot more comfortable with the finance. They can blend the capital that they get from their investors with other conditional capital to de-risk their funds.”
- “I think it’s all down to how you structure the guarantee and the devil is in the details. I think they can be structured really attractively and less attractively so it depends, it can be very effective as a tool in terms of various ways of doing first block guarantee.”
- “The banks didn’t like the guarantees, because when you have a guarantee there are certain conditions that you have to fulfil and if you don’t fulfil the conditions then the guarantors will say actually you didn’t assess the contractors properly. Therefore we are not paying out guarantees.”

5.5.4 Impact values alignment

The profile of investors in South Africa has been identified as one of the reasons why the fund managers do not take on risk, which influences the companies they target for investment. Intuitively, in balancing the financial and impact return, which will happen at the investee level, is ensuring that the manager’s mind-set and values are aligned to the vision of the social enterprise. This will also ensure that when tension arises at the investee company, the manager is able to call it out and get the social enterprise to focus again on impact, which could be articulated in the contractual agreement. These were some of the comments made with regards to impact value alignment:

- “The only way to really mitigate risk is to make sure the investor has a similar mind-set. You actually need the people who run it and the people who invest in it to be on the same page.”
- “We find that entrepreneurs are attracted to our fund given the way we are positioned and our own value system that we try and portray, they also tend to be of a similar type, equally concerned about acting with integrity and obviously honesty and a real focus on the high-quality performance and customer service.”
- “It is the intent of the investor that carries more weight because when it comes down to making decisions where there is, [and I do think that in some instances there is] a

trade-off between profit and social impact, and the investor doesn't care about impact, you going to have a fund manager that follows the lead of the investor.”

5.5.5 Investment approach

All investors have different investment ethos and processes of driving value in their investee companies, which could play a big role in weeding out some of the risks and ensuring investment success. The respondents acknowledged that business management is the investee leadership's responsibility, and it is probably a significant part of the investment, however there is a role that the managers can play to keep them accountable to ensure that there is no mission drift.

- “So that is the big differentiator, not to say that in other parts of the business they are not doing that as well, but we have just found that this asset class requires specific, proactive, on the ground management approach to make a space, which is an otherwise difficult space, work.”
- “You need excellent staff who really can understand things, make decisions on the go, see the nuance, see the complexity and not be bowled-over and get starry-eyed by the fabulous impacts you are making in social economic terms on the investees, don't get overwhelmed by that, you have got to be hard.”

Some of the themes that were identified when discussing the investment strategies are discussed below.

5.5.5.1 *Driving Impact*

Not only can active management deliver financial value, but three of the respondents also stated that, as part of the investment approach, the asset managers can drive impact. One of the respondents stated that, as a black-led organisation, often in their investee companies they will specifically lead the social and ethics committees, as that gives them an opportunity to drive transformation in the organisation. These were some of the comments made:

- “We then are able to influence things such as transformation in the companies that we are investing in, for example, in some of our companies, we've gone from a state where human resources and all that stuff was a nice to have to a case where it's now at the forefront, it holds a high position on the agenda as the financial performance and everything else.”
- “I'm not a big fan of very passive investors. I think if you're a true impact investor you're trying to be active. You're trying to nudge policy. You are actually trying to say in each of your companies this is your financial hurdle and this is what I expect from you. Just

think hard, keep working until you come up with them and you're going to still meet your targets. That, to me, is how you actually drive impact in a smart way."

5.5.5.2 Governance

Some of the respondents, as part of the investment approach to mitigate risk of failure at the investee level, request changes to the governance structure of the investee company. This could be done by the manager putting a representative on the Board of Directors in order to push their agenda or ensure that the investee company is not drifting from the mission, or it could be done in order to assist the investee company from a strategic point of view to scale-up and unlock growth opportunities. These are some of the comments that were made with regards to the governance structure:

- "In the investee company we always offer our natural skills, being the corporate governance side or the audit committee capability, finance capability, drawing from our broader database to the extent that there is a skills shortage at the investee companies. We get involved to the extent of management assistance from unlocking the opportunities from a networking perspective. We gladly attend those business developments meetings."
- "There's certain types of business we will come in and say, we're going to have a Board position because B-BBEE is important for this, or whatever the case, maybe it's not B-BBEE. We need a Board position because then we are able to drive the agenda of the organisation and if they say no, we will walk away."
- "There's actually some fund managers that will subsidise the cost of getting a highly skilled and well networked Board member on a business' Board, because that helps a lot in terms of opening a lot of doors because the business will then have this person who knows people."

5.5.5.3 Impact sectors

Different strategies are instituted by the investors to achieve impact. Some respondents felt that one could focus on a high impact sector, where the impact is integral to the business activities. A typical example of this is providing high quality, affordable healthcare to the bottom of the pyramid. This strategy in itself will ensure high impact, and if the business model is executed well, high returns. These were some of the comments regarding high impact sectors:

- "I think some of them do not experience trade-offs, as their impact is so integral with their business model that they go together. So like the business becomes more profitable by actually serving that specific market because that's what they are good at."

- “You set your hurdle depending on the sector you’re in and the opportunity to blend in. There are sectors where no-one has bought an impact lens and you should be able to pick up lots of free impact without trading off commercial returns. There are other sectors where all of the easy impact has already been grabbed and if you want to do more you’re going to have to do things that don’t make pure commercial sense and there you discount.”
- “The interesting businesses are actually not the businesses that identify as social businesses, but that are first in an industry that is social in nature.”

5.5.6 Development of case studies

The respondents, when talking about how Impact Investing and other sectors have developed, stated that sometimes it takes the development of case studies to demonstrate to the market that impact can be generated in a commercially sustainable way.

- “It did not only influence policy, but they influenced policy by doing things to show that this can be done. They had a strong delivery sector, they actually did help with the mantra that if you want to bring in the private sector to deliver housing you had to show you can do housing, provide development housing finance and you will get your money back.”
- “I think like anything at the start, it’s really been a few key people, who have made a decision and have been fortunately influential and able to drive some of the funds that we’ve worked with and they’ve kind of committed to it and demonstrated success.”

The track record of the pioneers in Impact Investing, specifically talking of exits, will also go a long-way in moving the perception of trade-offs. The track record will also assist in driving capital into the impact space. These were some of the comments made regarding track record:

- “We have seen that with that track record, we have been able to build capacity with additional investors and we have generated a lot of internal IP on how to develop and manage these large-scale projects given the delays we experienced. So I think that is also an element of our risk mitigation.”
- “We tell these good stories about how we’ve identified these really exciting businesses that’s doing these really exciting things at the bottom of the pyramid, somewhere rural, then that’s kind of where the story ends. So, I’d like to see some more case studies on the exits that have certainly created both a social and a financial return.”
- “First time you approach the investor, and they ask how long you have been going? We would say we have only been doing it for two years, they say come speak to us when you are doing it for five years. When you go after five years, they say come speak

to us after ten years. Then after ten years they ask you how big are you now. Then you say like R200 million, and they say come speak to us when you are like a billion rand.”

- “The biggest challenge for a first-time fund manager, and most of them are in the Impact Investing space, is that you don’t have a track record and the investors see that as a risk.”

5.5.7 Leadership team

Most of the respondents also cited having the right leadership team as a form of risk mitigation. To ensure that the leadership is focussed on the long-term success of the company or project, the investors would require that the leadership holds an equity stake in the business as well; this is from investors who will use equity in the finance structure. The respondents made the following comments:

- “We need our partners who are ultimately our managers of the investments to be vested in it. It is the only way to make sure that they have the same long term focus as what we do. One of the other biggest things for us is obviously that risk of the counter party not being able to perform in the way we anticipated and we tie them in on an equity basis so they are equally motivated.”
- “We had to walk away from a few transactions because the original owner, didn’t want these other managers to own a stake in the business.”
- “The biggest mitigation is investing in the right team; nine times out of the ten the difference between success and failure is the ability of the team to manage complexity and ambiguity.”
- “I think the way to mitigate risk is only in terms of the capacity and the effectiveness of the staff and the management, the people who are actually dealing with it. That’s how I’d mitigate risk. People must be really clued up, they must be strong minded, soft hearted in that they want to do good, but very strong minded.”

5.5.8 Millennial push

The investment landscape, as mentioned by some of the respondents, is transitioning, with millennials moving into the workforce and some inheriting significant wealth. The respondents stated that this generation of investors’ cognitive framing of the business environment is a hybrid, with significant impact on the socio-environment landscape. They will drive capital towards Impact Investing and change the thinking around risk in the business environment by legitimising ESG risk.

- “I think we’ve seen a generational shift in who controls wealth. You’re seeing a huge concentration of wealth and you’re seeing a growing openness, particularly with self-generated wealth as well. You’re seeing a growing openness to the idea that core business innovations can deliver social impact.”
- I think everyone at heart wants to do the right thing and I think the younger generation actually almost more strongly come through with that sort of desire to do the right thing. It’s a little bit naïve sometimes, but it’s one of the things that I’ve picked-up from the loan officers in the company and we need to be able to convert that sort of naïve enthusiasm into something that’s sort of real and can have a life of its own.”
- “For them it’s really just them trying to put their money where their values are, there’s a huge drive for this amongst women, millennials, entrepreneurs who just sold their companies and made lots of money; they’re more interested in putting that money not in charity but in putting money in other people’s ventures and making a difference.”

5.6 Research question 4

How do impact investors measure socio-environmental returns (impact returns), and is impact measurement incorporated in the overall measurement and reporting of company performance?

The GIIN definition of Impact Investing has been widely adopted and has, at its core, measurement of the impact achieved. The South African Impact Investing sector resonates with this element; all the interviewed respondents agreed that the industry players have some form of measurement metrics in place, however comparability will be an issue as they were all different. The respondents were asked if they were measuring impact and how they were measuring it. The themes that were identified from the responses are tabulated below in order of the most frequent theme that appeared in the data collected:

Table 17: Considerations of impact measurement

Ranking	Measurement theme	Number of respondents
1	Impact Measurement	15
2	Regulation and Policy	13
3	Reporting Cost	9
4	Measurement Tools	8

5.6.1 Impact measurement

The respondents were first asked if they were measuring impact, and as a follow-on question they were asked how they were measuring impact and if that was something that their

investors required. The following table lists the themes that were covered, ranking them according to how many respondents identified with each theme:

Ranking	Measurement theme	Number of respondents
1	Are you measuring impact?	9
2	Measurement process	7
3	Investor requirement	4

5.6.1.1 *Are you measuring Impact?*

Nine of the ten asset managers sampled measured impact; the respondent who answered negatively explained that the measurement is performed at an investee level, however it is not aggregated and reported at the fund level. The most important element of impact measurement is articulation of impact, which refers to what the impact fund considers as an impact area. These are some of the comments that were made with regards to impact measurement:

- “I believe talking to your beneficiaries and letting them set the impact is ultimately the most important thing. I used to want to report on hard numbers and data but I think a lot of it is smoke and mirrors quite honestly, because if I decide, me, in my ivory tower of what I think impact is and I go and measure that and I find that data and I clap myself on the back and go yes I’ve done my impact but the beneficiary goes you know my life hasn’t improved at all. You’re like but you’re making two dollars a day now instead of one dollar a day, why aren’t you happy. If they’re not happy with that their life hasn’t changed. So I like participatory impact assessment, I like that kind of feedback.”
- “Fund managers are quite happy to measure things that are outputs, maybe an outcome level but no one is measuring at an impact level. You know, generally in this space, we really are just output investors, but those things are being measured.”
- “It’s a consumption good. You know it when you see it and you determine what it is for you as an investor. It’s an attempt to come up with a single conversion ratio, like how many school children must you put through class A in order to be equal to saving one child’s life. That’s nonsense. It’s a consumption good.”

5.6.1.2 *Measurement process*

A concern about the current measurement practices is that what is being measured is not impact at the beneficiary level but rather output. What also came up as an issue, especially in the jobs space, is that there is double accounting and a concern as to whether permanent, real jobs are being created. The impact funds also rely heavily on the investee companies to

collect the data, which is then integrated and reported at the fund level. These were some of the comments regarding the process and what is being measured:

- “We then sort of write it into the business, it makes it easy to get information. Take the information, aggregate it and take it forth from there.”
- So when we even issue a term sheet. We say in there that one of the metrics that we will require from our investing companies is the job creation number over a period of time. So it starts from when we make our investment and then we measure it on a quarterly basis and we count, its permanent jobs, but we can also account for a full time equivalent. So if we have some more part time workers but not contractual workers *per se*, but part time workers over an extended period of time we make adjustments. So if we have two people working half day that’s equivalent to one job.”
- “So we typically use consultants on an annual basis to come in and assist us in compiling all the investment research and we have got a lady internally who does it and we make sure that it is written into our legal agreements so that the counter party, managing the investments, knows which information to provide.”

5.6.1.3 *Investor requirement*

The Investors’ mandate influences a lot of the objectives of the fund, therefore questions were asked in order to ascertain the investors’ influence on the measurement and reporting of impact. The general view from the respondents, especially in the institutional space, is that the investors are not so interested in impact reporting, and therefore reporting is driven by the managers who decide what impact to measure, by writing it on the term sheets issued to the investees when contracting. These were some of the comments made in respect to investor requirements:

- “For us it came through the way that we raised our capital but I think for other funds it can come about a different way but I don't think you can now be in the space and have a very loosely defined impact.”
- “We’re donor driven, we’re investor driven for example, if a social enterprise or a fund receive money from the Jobs’ fund for example, then they measure jobs. So is that always the best measure of what they are doing, often not. I think there is a lot of measurement that’s happening but is it useful measurement? Not necessarily.”

5.6.2 *Regulatory policy*

Regulation plays a peculiar role in the South African impact Space. On the one hand, it has been driving capital into Impact Investing in the form of B-BBEE and the enterprise

development requirement under the new codes, as it is driving corporates to start thinking and integrating impact into their businesses. On the other hand, regulation has been heavily critiqued and there have been many debates as to whether B-BBEEE can be thought of as Impact Investing. Five of the respondents discussed this, three of whom thought it was Impact Investing, whereas the other two respondents critiqued it due to unclear impact measurement requirements and whether the regulation is effective in achieving Impact. These were some of the comments made regarding regulatory reporting and measurement:

- “You see a lot of tick-box thinking in everything, from how you think about skills in the work force to how you think about diversifying supply chains etc. Everything is: ‘I’ve spent 10% of this or I’ve hired 5% of that’, as opposed to actually how I can capture competitive advantage from doing things that no-one else is doing or doing things better than other people.”
- “I think if people are putting money into businesses that happen to have a positive social impact but the investor doesn’t care about it or doesn’t measure it, it doesn’t matter to anyone whether we call them an impact investor or not. I certainly wouldn’t.”
- “If you look at the definition of Impact Investing by the GIIN it’s got in it ‘measurable’. Whereas B-BBEE and enterprise development could be Impact Investing as people are implementing it, but the onus would be on them to measure as the policy and the legislation works right now. All you’ve got to show is that you’ve given that money away, there’s no incentive to measure.”

5.6.3 Reporting cost

The respondents, when relating the measurement processes used, brought-up the cost issue, which drives the level of the reporting that takes place. The costs should, however, not negate the measurement and reporting of impact, as it legitimises the investment strategy. These are some of the comments made:

- “I think the only additional cost which is consistent across impact businesses is the reporting costs, it is quite difficult to deal with that.”
- “A traditional business is very clear on what they measure, what’s important for you to understand their business and social businesses need to take responsibility as well for measuring what’s important for their business. So if it’s integral to the service that they’re delivering etc., then they should take responsibility for that from a cost perspective in the same way that your traditional business might measure a client satisfaction or market penetration etc.”
- “In terms of the business case there are significant costs to the impact level of reporting that we have to do, that is also then taking into account effectively the business case

and how we are responsible for and required to report on that basis, because that reporting is not inexpensive.”

- “To prove the business case for Impact Investing you have to be able to show both success in the impact and success on the returns and there’s no way you can do that without doing impact measurements. It’s kind of like the critical part of and the extra cost of being an impact investor.”

5.6.4 Measurement tools

Standardisation would allow for comparability and make it easy for the general public to understand the measurement metrics being used, however due to the strenuous regulatory reporting requirements already in place in South Africa, there is often push-back on the question of another compulsory reporting standard. The respondents also shared that it would be difficult to have one standardised metric, as the impact investors have different impact areas and impact means different things to different investors. There are a lot of developments in the impact space that aim to design a standard measurement tool that will promote comparability, yet only two of the respondents are currently integrating elements of IRIS (International Reporting Impact Standards) in their measurement process, and only two other respondents incorporate the Financial Sector Charter targets into their reporting.

- “Giving houses to 400 people is not the same as giving jobs to 50 people. It is different, different needs, what is more important? And therefore we have made the impact for certain categories more and then we came to a model. And it is almost like, it is like an algorithm now.”
- “We come up with our own measure. I think that measurement is over complicated, if you start to look at all these schedules, I think it's over complicated. So I think you have got to decide not what the universal measurement criteria are, but what matters to you as a company.”
- “When we’re helping people we always advocate for moving towards comparability so what is out there that’s going to work for you, that can also help you benchmark yourself against others because as things and the sector kind of professionalises, grows and formalises you want to have that, you want to be able to compare different types of organisations, however, measurement is about what’s useful for you as an organisation and I haven’t seen a one size fits all solution.”

Chapter 6: Results Discussion

This chapter links the results detailed in Chapter 5 with the literature review in Chapter 2, in order to draw comparisons and provide new insights. This discussion follows the framework of the questions in Chapter 3 with the objective of identifying the trade-offs, if any, of Impact Investing. It further attempts to develop a framework so the competing logics of impact optimisation and profit maximisation can exist in paradoxical harmony. The results contribute to the field of Impact Investing by providing a deeper understand of the Impact Investing framework and supporting the legitimacy of the investment approach.

6.1 Research question 1

What factors do impact investors consider when constructing an investment portfolio?

The objective of this question was to gain insight into the factors considered when constructing an Impact Investing asset portfolio. The interviews revealed that, at most, the investment decision process for Impact Investing is similar, in all respects, to how decisions are made in conventional investing, with the addition of impact screens. This finding is consistent with the 2016 GIIN Annual Survey findings, as it reported that more than 50% of the respondents who discussed the due diligence processes screened assets for impact, with about 20% having significant differences in the due diligence process (GIIN, 2016). The respondents' decision to invest was made on the basis of a risk matrix that assessed the financial risk of the target company, however these are not sophisticated. The results are discussed below in more detail.

6.1.1 Financial risk

Impact Investors make investment decisions based on personal values and a need to make social and environment impact, however the respondents all agreed that financial risk is still a factor in making investment decisions as they also want to make returns. Furthermore, to be able to finance impact the model needs to be sustainable, therefore the capital needs to revolve. Financial risk has been at the centre of finance theory, as reflected in the discussion of Modern Portfolio Theory (MPT), which asserts that returns will be maximised through the construction of an asset portfolio which efficiently compensates for taking on high risk with high financial returns (Markowitz, 1999). Variance is used as a measurement of risk in MPT, however Farmen and Van De Wijst's (2005) argument that the firm's ethical characteristics are not reflected in its other investment characteristics, like the variance, is true of Impact Investing. The respondents identified three factors that impact the ability of managers to take on risk, which are discussed below.

6.1.1.1 *Investor profile*

The investment mandate is a critical element for managers when deciding which assets to invest in, and therefore it is important for understanding the investors' risk profile as it determines the managers' ability to take on risk. Effectively, this concept drives the consideration of only one stakeholder in decision making, which is consistent with Viviers and Eccles' (2012) findings that the biggest challenge for the impact institutional field is the fiduciary duty concept, which requires management to focus on the interests of the company's owners only. This is more so for fund managers, as not following the mandate provided by the investors could affect the manager's ability to raise funds in the future.

The results, however, also showed that all is not lost, as there is capital in the market earmarked for Impact Investing as there are different investors in the market. This view is consistent with Derwall, Koedijk and Horst's (2011) categorisation of impact investors into two groups - the values-driven approach and the profit-seeking approach. The values-driven investors should be willing to accept a lower return for higher impact, however this study's analysis of the investors' profile shows that only Development Finance Institutions and grant funding ear-marked for B-BBEEE and enterprise development have high risk tolerance. This is consistent with Jones (1999), who stated that decision makers, who by virtue of deciding on the investment mandate in this case are the investors, need to possess values consistent with social responsibility and must be able to apply them in decision making. The DFI's funds and B-BBEEE are grant based, and thereby aim to just preserve capital and not gain high returns.

Other scholars assert that Impact Investing could be seen as another asset class, where the investors are opportunist in nature, possibly seeking high returns in this asset class (Viviers & Eccles, 2012; Beal, Goyen & Phillips; 2005). These types of investors were not observed in the results, which could be due to the infancy of Impact Investing in South Africa and the fact that the asset class has not matured to a point where a significant portion of the assets in Impact Investing are listed, giving room for speculative, high-risk trading. One respondent acknowledged the lack of capital with high-risk tolerance flowing into this investment space, while another noted that the hardest thing to do is linking the right asset with the right capital, thereby aligning the investor's goal, which could be impact optimisation and/or profit maximisation, with the goal (or capability) of the company. Notably, institutional investors are the largest contributors of capital, consistent with the 2016 GIIN Annual Survey.

6.1.1.2 *Finance structure*

The results show that the market is currently using variations of equity and debt financing, with some form of securitisation structures, first loss seed financing and limited use of guarantees. The majority of the respondents use debt financing, which is consistent with the 2016 GIIN Annual Survey. The use of debt shows that there is an aversion towards risk in the South African impact space, and this directs investments towards growth to maturity phase assets, which was observed as the majority of the asset managers interviewed invested in growth or maturity phase investments. Neil (2016) emphasised the need to match capital with relevant investments. This matching was observed in the results, however it pointed to a gap in seed-funding as there is insufficient capital in the market ready to absorb the risk. This could be an opportunity for the introduction of innovative financial structures, along the lines of Social Impact Bonds, to bridge the gap. King and Gish (2015) noted that it is at the intersection of the impact logic and profit logic that innovation breeds.

6.1.1.3 *Liquidity*

All the asset managers interviewed invest in unlisted assets, often with long-term investment horizons, and therefore most identified liquidity as big concern in the impact space. This is a phenomenon that was identified not only in South Africa, but globally as per the 2016 GIIN Annual Survey. The South African impact space is still in its infancy and therefore there has not been a lot of successful exits which could possible create a secondary market for Impact Investing. Most assets are held to maturity, or if it is equity, the investments are fairly new. As Neil (2016) stated, this risk is not a concern only in South Africa, but is customary in frontier markets. The respondents stated that liquidity risk affects their investment decisions and is priced-in, which is consistent with Neil (2016) when he stated that the risk can be reduced by considering the exit route at the time of investment. The implications of this in the South African impact space due to limited exit routes is that a lot of opportunities would be ineligible for investments, thereby contributing to the pipeline issues.

6.1.2 *Impact factor*

The majority of the respondents agreed that impact factors are considered in investment decision making, which is consistent with the view in behavioural finance that investment decision making involves other emotional and situational factors besides risk (Steuer, Qi, & Hirschberger, 2007; Peylo, 2012). This is contrary to Bilbao-Terol, Arenas-Parra and Canal-Fenandez's (2012) assertion that due to the singular lens of MPT, many managers are not considering sustainability factors in portfolio constructions. The observation from the data collected is that there are no sophisticated models of selecting assets, and neither is the process significantly different from conventional practices, consistent with the 2016 GIIN

Annual Impact Investing Survey. The following factors were identified as issues that drive the impact agenda within the investment company.

6.1.2.1 *Investment team*

The respondents were observed to have a strong sense of responsibility and passion in driving the impact Agenda in their organisations. This is more so as the South African impact space is new, and therefore they are pioneers navigating through uncharted territory. The respondents understood the space to be challenging from all fronts, however it is their passion to make a difference that is driving them. Most are finance professionals who are passionate about development and who are willing to navigate the difficult operating environment. This is consistent with King and Gish's (2015) findings, when they stated that operating with this tension of the competing logics has led to innovations in how to think about and perform Impact Investing.

The individuals within the teams possess the social as well as the profit logic, particularly from their finance background. This observation is different from Pache and Santos' (2010) representation concept as it requires adding internal representation for both logics, however as the results show, one person can represent both logics. This could cause tensions between the two logics if the individual representing them has to make a decision one way or other. Pache and Santos' (2010) study enforces that for a balance to be achieved, both logics, the impact and profit logics, need to be represented for there to be a form of compromise internally. One case presented by a respondent, which proved to be effective, was for the logics to be represented by two separate teams running due diligence from each lens and each with veto power. This ensured that the impact is not sacrificed for profit. This is consistent with Battilana and Lee's (2014) assertion that effective hybrid organising requires individuals to embrace the organisations' hybridity and share in its values.

Having the right team will require recruitment policies that embrace the company's hybrid goals. The recruitment policies, as asserted by the respondents, also reflect the impact values and need for potential employees to understand and appreciate the complexities and be open to finding new ways of doing things. The respondents explained that the company messaging (corporate identity) is also critical in attracting the right people, and some experienced this to be effective even though the impact space is not as lucrative. People attracted to this space are willing to take pay-cuts just to join the teams. This is consistent with Battilana and Lee's (2014) study, which revealed that it is critical for there to be a common identity which is fostered in recruitment policies and internal socialising.

6.1.2.2 *Investor motives*

Strong adherence to the impact agenda, as per the researcher's observations, is not only driven by the investment team, but also by an alignment of values with the capital providers. The respondents explained that investors, through an instituted investment mandate, drive the impact agenda in Impact Investing, and ensure that the managers do not drift from the impact mission. Renneboog, Horst and Zhang (2008) explained that impact investors specifically are driven by varying personal ethical and social convictions, while Lewis (2001) stated that some investors view investing as an extension of their lifestyle or identity. Therefore, at the forefront of Impact Investing, are investors wanting to do good while doing well, thereby influencing the impact agenda and forcing asset managers to develop impact instruments. The respondents use specific funding earmarked for development or for a specific impact Agenda, and hence strongly adhere to the agenda.

6.1.2.3 *Regulation*

The respondents agreed that regulation, especially B-BBEEE, has been driving capital growth in Impact Investing, even though as the results reveal, the respondents do not think that the changes in Regulation 28 of the Pension Fund Act has changed the industry's allocation of capital to Impact Investing. This is consistent with Peylo's (2012) assertions that regulation could be instrumental in driving capital into Impact Investing. Renneboog, Horst and Zhang (2008) observed this in the European context, as regulators started requesting companies to disclose impact on social and environmental factors. The low allocation is due to the fact that the pension fund industry still perceives Impact Investing as high risk, consistent with the findings reported in the 2016 GIIN Annual Impact Investing Survey. The amendments of Section 12J of the Income Tax Act are new and only a few of the funds are listed so far, therefore it is too early to assess whether this change in regulation has had any effect in driving capital into Impact Investing.

6.1.3 *Leadership team*

The essence of the investment ethos is trusting someone with your money as investors are not managing the businesses on day-to-day basis, therefore six of the respondents identified the management team as an important criteria to consider in investment decisions. This is consistent with Neil's (2016) assertion that rigorous vetting of the management team is a critical factor in asset selection, as it could determine the success or failure of the investment. The respondents further stated that there needs to be an alignment of values with the target company's investment team, especially in relation to impact, as it can reduce risk of mission drift. This is consistent with Jones' (1991) assertion that the decision makers should have social values as well as profit motives, as that will drive decision making at the investee level.

6.1.4 Experience

Experience of the target company in the sector shown in the form of financial growth or success in identification of opportunities was identified as an important criteria that the respondents look for when constructing a portfolio. This is influenced by the fact that most of the respondents only start investing in companies that are in the growth or maturing phase. The 2016 GIIN Annual Survey identified business model execution as a risk in Impact Investing, therefore it could be that seed or new venture investing is avoided in order to circumvent the risk. This is not consisted in Neil's (2016) observation that start-ups and early stage ventures are a popular investment target in Impact Investing. Only one respondent invested in early/seed stage, and the risk could only be absorbed due to the fact that the respondent used grant funding earmarked for B-BBEEE opportunities as the respondent was only concerned with capital preservation.

6.1.5 Conclusion

The results revealed that the main factors considered when assessing an impact fund is first an analysis of the risk profile of the deal. The ability of the Impact Investing asset manager to take on risk is influenced by the investor profile, the finance structure and the liquidity in the market. The second factor affecting the fund construction of the impact fund is the socio-environmental impact of the investment opportunity. The impact factor is driven by the investment team, pushing the challenging Impact Investing climate to find innovative ways of generating impact, then it is the investors' motives instituted through the investment mandate that drive impact. Regulation has been identified as a critical factor driving capital flows into the impact space. The leadership of the target entity and the experience in the form of a track record have also been identified as critical factors in investment decision making. At the core, the impact investment decision process is similar to conventional investing, with the addition of the impact factor.

6.2 Research question 2

What are the trade-offs (or impending risks) of Impact Investing? This refers to both financial and non-financial risks.

Building on what is considered when constructing an impact portfolio, this question sought to find out in simple terms whether the respondents have thought about the trade-offs, if any, in Impact Investing. The observation included both extremes, with each side having a strong belief on the subject, and a middle range that is solution-oriented, i.e. they believe there are trade-offs but they can be overcome or they have been accepted. Some noted that perhaps the trade-off is the opportunity cost of not pursuing a pure profit business model, as in a sense,

successful entities feed back into the economy through GDP and tax contributions. Ultimately it is government's responsibility to ensure social and environmental development. This view is short-sighted, some argue, and the hope is for all businesses to operate with an impact conscience within the context of their environments.

6.2.1 Return expectation

The respondents were classified based on their responses regarding whether they have returns expectations, which are discussed below.

6.2.1.1 *Market related returns*

The majority of the respondents felt that the return expectation should be market related due to the fact that the funds need to revolve, and in order to raise funds they need to show investors that this investment approach is lucrative. Furthermore, the risk metrics used were similar to conventional investing, therefore the respondents felt that investors should be compensated for taking on high risk by investing in these types of assets. This is consistent with the 2016 GIIN Survey, which found that the majority of the respondents have a market related return expectation, even though performance could be different. Targeting market related returns is not impossible, as the majority of the studies (Viviers & Eccles, 2012) show that there is no significant difference between the performance of conventional funds and impact funds. One of the respondents stated that, when starting the fund, their expectations were market related, however experience showed that they should adjust their expectations down.

6.2.1.2 *Deal by deal basis*

The respondents managing assets explained that returns expectations could be set for a portfolio, whereas at deal level, the return would then be managed based on the risk profile of the transaction. Therefore, a trade could be done on a deal to either aim for high financial return or high impact, counting on other deals to make up for the other element. This shows that what drives performance at a portfolio level is the manager's skill in asset selection and rigour in risk assessment. This is consistent with Stankevičienė and Čepulytė's (2014) findings that the performance of the funds is influenced by human and intellectual capital efficiencies. Five of the respondents felt that it is prudent to set expectations and manage the investment fund on a deal-by-deal basis, as each asset has a different risk profile. Perhaps a best-in-class analysis could be adopted to select the best financial performing asset in an impact sector, as suggested by Neil (2016). Stagars (2014) suggested that this could be performed by instituting a rigorous risk assessment process, which will reduce counterparty risk and management overhead of the fund over the term of the fund. Furthermore, King and Gish (2015) explained

that continual analysis and monitoring of the sustainability of an industry could lead to the identification of the best actors in that industry, and therefore result in high Impact at both deal and portfolio level.

6.2.1.3 Capital preservation

Three of the asset managers interviewed explained that, due to the fact that their funders were Development Finance Institutions and B-BBEEE grant funders from corporates, they manage for capital preservation. The respondents explained that they would like to get good returns, however they consider return of capital invested as doing well. One of the respondents noted that even though they normally aim for return of prime plus two, they were currently receiving prime minus four which was lower than expected. The 2016 GIIN Survey revealed that 16% of the respondents expect at least capital preservation, and found that of those expecting lower than market return, only 13% underperformed compared to expectations.

6.2.2 Operating environment

6.2.2.1 Regulation and policy

Regulation could be an enabler in light of B-BBEEE driving capital into this space, which is consistent with Ndhlovu's (2011) findings. However, as stated by one respondent, it could also be a barrier to Impact Investing. For example, the prescription of asset allocation in pension funds could result in a misalignment in values, and thereby result in the asset managers encountering trade-offs. The B-BBEEE legislation has also been critiqued, as companies are now using it just for compliance and not thinking hard about the impact that result from actions undertaken.

6.2.2.2 Government

The findings reveal that government could be a potential enabler in terms of crowding in investments, however it could actually crowd out investments by competing with the private sector for the limited opportunities, thereby increasing the risk of investing in a sector. Government processes have been identified as a significant barrier at the investee level as the delays caused could potentially increase the cost of doing business and therefore eat at the margins of that business. The G8 taskforce stated that government has the potential to drive capital into Impact Investing (Social Impact Investment Taskforce, 2014), therefore perhaps it should actively look at opportunities of collaborating with the private sector and reducing the bottlenecks experienced by businesses when dealing with government offices.

6.2.2.3 *Macro-economic environment*

The macro-economic environment, which is made up of different factors, could be a barrier to Impact Investing, however as some of the respondents mentioned, it is important for businesses to immerse themselves in the demands of the operating environment or communities they are situated in. This element of the operating environment could also assist in the framing of the Impact that the asset managers want to have, as per one of the respondents who makes a choice to support government initiatives when it is lucrative to do so. Another respondent frames impact based on the funding received from the investor, which contextual, fits in the operating environment as it has been identified as a need. This consideration of the operating environment is consistent with the external environment elements noted by Pache and Santos (2013) in their model of selective coupling.

6.2.3 Impact factor

The majority of the respondents consider impact factors in decision making. This is consistent with behavioural finance, which asserts that investment decision making involves other factors (like Impact) besides risk (Peylo, 2012; Steuer, Qi, & Hirschberger, 2007). Yet the incorporation of the impact factor in decision making could be limiting in terms of the population of assets in the market that meet the impact requirement (Neil, 2016; Stagars, 2014). This limitation causes tensions with the profit logic as the diversification of risk would be limited, meaning the managers would have a higher financial risk exposure and it also could result in sector concentration risk (Renneboog, Horst & Zhang, 2008; Blanchett, 2010). Furthermore, the pipeline of investment opportunities meeting the impact requirement could, as experienced by the respondents, be an issue. Some of the respondents stated that in the South African impact market, several managers often have the same assets in their portfolios. The respondents, even with this understanding, had varying responses to the question of trade-offs as they all viewed them through different lenses, which are discussed below.

6.2.3.1 *There are trade-offs*

The majority of the respondents believed that there are trade-offs in Impact Investing. These respondents viewed themselves as pragmatic and felt that it is more damaging to advocate for no trade-offs instead of advocating greater shareholder value, as Impact Investing created shared value. There was also an acknowledgement that the risk might not be the same across all assets or sectors, as some sectors might be inherently risky, for example seed stage finance. This risk was specifically identified by Neil (2016) as one of the challenges of Impact Investing. Furthermore, Pache and Santos (2010) explained that not all organisations face conflicting institutional demands in a given field in a similar way, and this will also be impacted depending on how an organisation interprets internal and external pressures.

The respondents explained that, due to the fact that most of the assets in this space are unlisted and generally in frontier/emerging markets, the risk of financial loss is high. This view is consistent with the challenges identified by GIIN (2016), Neil (2016) and the UNDP (2015). Neil (2016) added that some of these risks (unproven track record, seed stage investments, unlisted, liquidity, etc.) are layered in one investment fund, significantly increasing the financial risk. Furthermore, impact risk, i.e. the risk of the company not achieving the intended impact, exists, which could be a product of mission drift. Brandstetter and Lehner (2015) defined impact risk as a measure of uncertainty that an organisation will deliver on its proposed impact. The respondents identified mission drift as a significant risk, as it is possible that the investee companies could shift their focus away from impact in pursuit of high profits in the short-term.

6.2.3.2 Perception of trade-offs

Some respondents felt that there are no trade-offs as research has proven, however there is still a perception in the market that trade-offs exist, as doing well was previously seen as a cost to the capital contributors. This perception could be driven by the lack of a conformed definition or understanding of what an impact investment strategy entails, as seen by the different approaches to achieving impact or integrated ESG factors in the investment decision making. One example is reflected in the Bertha Centre's Barometer, which lists four approaches to investing for impact (Giamporcaro & Dhlamini, 2016). There are also empirical studies that allude to the cost of integrating impact factors in investment decision making (Viviers & Eccles, 2012), which could be due to different definitions being used. Information on sustainability is not readily available (Renneboog, Horst, & Zhang, 2008), and the market is said to misprice sustainability information (Adler & Kritzman, 2008), further prolonging the perception of trade-offs.

6.2.3.3 There are no trade-offs

These respondents supported their stance by first referencing existing empirical studies which found no significant difference between Impact Investing and conventional investing. This is as reported by Viviers and Eccles, (2012) who found that the majority of studies showed no significant differences between the financial performance of impact funds and the performance of conventional funds. Secondly, these respondents felt that there are enough business cases of high performing, high impact companies in the market, especially in inclusive banking or microfinance institutions, to prove the concept of Impact Investing. This is reflected in Hayes' (2005) statement that the investment climate is rife with corporate scandals, therefore prudence towards ESG risk (Snider, 2015) could lead to high investment returns. Lastly, these respondents explained that it is ESG risk, which if not weeded out by investing only in impact funds that could result in financial underperformance. This is consistent with Neil's (2016)

statement that better screening for ESG risks, which affect the social impact of an investment, can reduce the financial risks and improve performance. These respondents were not ignorant of the challenges facing Impact Investing, however they believed strongly that these challenges could be effectively managed and the risks mitigated innovatively.

6.2.4 Fund structure

The fund structure was observed as a possible reason for the tension between the impact and profit logics. Specifically, an element of the structure that could possibly cause the tension is the legal structure of the investment company, which inhibits its ability to effectively manage both the impact and profit logics. A significant majority of the respondents had a for-profit structure. Pache and Santos' (2013) 'selective coupling' model lists ten dimensions, amongst which the legal status of the entity, its ownership structure, and the profit destination were identified as critical to ensuring paradoxical harmony. One of the respondents had a hybrid model whereby the non-profit entity was a shareholder in the for-profit entity, and the activities were impact and profit driven respectively. This hybrid could be effective in the South African market as Impact Investing is still in its infancy. Battilana and Lee's (2014) model on hybrid organising includes core activities as a critical dimension, and requires the integration of activities that achieve the social and commercial objectives to gain external legitimacy. The profit destination, as identified by Pache and Santos (2013), refers to the investor profile, which, as already mentioned, could direct the investment company towards either of the logics or towards both of them.

The ownership structure, as the respondents identified, could impact the fees charged for a fund's management services. If the fees are performance based, the shareholders might drive the strategy of the fund towards profit maximisation and not impact optimisation. Furthermore, if the compensation of the investment team is based on the financial performance of the fund, the fund managers would be biased towards profit maximisation, unless, as recommended by Pache and Santos (2010), there is effective representation internally of the impact logic. This is consistent with Battilana and Lee's (2014) hybrid organising model, which includes workforce composition as a dimension requiring individuals within the investment team embracing the organisation's hybridity and sharing its values. Battilana and Lee's (2014) hybrid organising model also includes the dimension of organisational design, which requires a reward system that measures performance based on the impact and profit logics.

6.2.5 Conclusion

The results from the second question were confusing, as even though the majority of the respondents stated that they had market related returns, the majority also stated that there were trade-offs in Impact Investing. The trade-offs are driven by four factors identified, the first

and key being the return-impact paradox, which is causing tensions in decision making that are exaggerated by the operating environment and how the impact fund is structured. The results also revealed that the trade-offs are not consistent across all impact businesses. The main risk elements of Impact Investing were identified as mission drift and the measurement of impact, which lie across all Impact Investing portfolios. The nuance of the results analysis revealed that perhaps the discourse on the understanding of the trade-offs is in the framing. Being framed as risks means that the elements are manageable, and hence there is less resistance from the respondents stating that there are no trade-offs if referenced as risks.

6.3 Research question 3

How do impact investors achieve the balance between the competing logics of profit maximisation and socio-environmental impact?

The balance, where impact is optimised and return is maximised, can be achieved, as identified in the data, through various means which are discussed below. However, some institutions are inherently built to achieve paradoxical harmony as the impact-return optimisation is integral to business activities. Also notable in the results was the drive from the founders or leaders of the organisations to embed the impact factor in decision making, which supports Luscher and Lewis' (2008) claim that emphasis should be placed on leaders to maintain equilibrium over time.

6.3.1 Legal contract

The respondents agreed that the legal contract, which could be in the form of term sheets or company constitutions, is an effective tool to manage and mitigate risk. Firstly, in securing the impact agenda, the contractual agreement could be used as 'mission lock' to curb the risk of investee companies drifting from their impact agenda. Secondly, the respondents stated that to secure financial performance and reduce risk, a contract is effective in articulating risk mitigation measures like securities, return expectations, distribution guidelines, covenants and required governance or management structures. Lastly, the contract could be used to ensure that the investee companies measure the right things and understand what data is relevant for measurement purposes. This is consistent with the 2016 GIIN Annual Survey, which noted that 65% of the respondents considered contractual commitments to be a very important reason for measuring impact. It is important to note that the appropriate controls for monitoring and review of performance against the agreement have internal representation to ensure that they are championed and enforced.

6.3.2 Risk assessment procedure

The respondents felt that the risk assessment procedures are not only a tool for identifying risk, but the more rigorous and meticulous they are, the more they could reduce the risks as the asset managers would be able to put the appropriate controls and risk mitigation tools in place. This is consistent with Stagars' (2014) assertion that when assets undergo a stringent qualitative assessment process before investment, a fund manager may decrease overheads and tilt the focus away from a hands-on management approach to more of a monitoring and benchmarking function during the life of the fund. This process, as alluded to by Stagars (2014), could help fund managers identify how much of an oversight an asset deserves, and thus they can make a decision as to whether they have the capacity to take on the asset and assist its leadership in a way that creates shared value, resulting in savings in fund management.

6.3.3 Finance structure

The impact space in South Africa has in many respects mirrored the conventional asset management investing space, as the financiers are the same and their expectations have not changed in lieu of developmental financing. Therefore, due to the fact that the investors are quite risk averse, the investment approaches have also been risk averse, resulting in a majority use of debt instruments in deal structures. This has resulted in the space being confined to investments in maturity phase organisations, which need large cash injections to finance expansion plans. The respondents felt that the risk averse nature of the investors has limited innovation in this space, which is a vicious cycle as looking to innovate could actually reduce risk. The top three tools used to mitigate risk in the finance structure, which are pricing, collateral and guarantees, have been adopted from conventional investing and are thought of as boring, as per one respondent.

6.3.3.1 Pricing

The respondents use risk matrices, which compensate the investors for the absorption of high risk, i.e. the riskier the assets, the higher the return expectations. This method was adopted from conventional investing, but some respondents felt that it is not effective in mitigating risk, as the increased cash requirements to pay the required interest could cash strip the business and increase the risk of business failure and loss of invested capital.

6.3.3.2 *Collateral*

Collateral as a risk mitigation tool is limited to asset type financing, where the investors look to the asset to repay the loan. The asset then stands as collateral, assuring the investor that should the organisation not be able to pay back the invested capital, then the collateral is security that could be sold to reduce losses and compensate the investors.

6.3.3.3 *Guarantee*

The guarantee is a risk mitigation tool that can be used to secure invested capital. Guarantees have been used in interesting ways within the impact space, where DFIs issue guarantees to Impact Investors, or they are used as first loss capital in some fund structures. The respondents felt that the guarantee could be limiting as the lenders of investors at times only decide to lend or invest up to the limits of the guarantee, signifying that there is no risk tolerance.

6.3.4 Impact values alignment

The respondents identified the need for value alignment amongst all critical stakeholders, ranging from the capital contributors to the investee companies, in order to ensure high impact and financial performance. This is especially true in the South African impact space, as Investors have been known to have a significant influence on the Investment mandate of the impact funds. Battilana and Lee's (2014) hybrid organising model includes the inter-organisational relationships as a critical dimension to achieving paradoxical harmony, as the investment organisation interacts with external forces either through financing or strategic partnerships, and it is important that the relationships are managed accordingly and not allowed to influence the hybridity of the organisation. Furthermore, Battilana and Lee's hybrid organising model includes culture as a critical dimension, which requires an organisational culture which is integrated based on the logics of impact optimisation and profit maximisation, acknowledging that the culture is dependent on the successful integration of the dimensions of hybrid organising. This would be applicable to the impact investment fund as a hybrid, and the investee company which would be a hybrid as well, as it is required to perform on the impact and profit logic.

6.3.5 Investment approach

The investment approach was identified as a critical element for achieving paradoxical harmony. The respondents referred to this as adopting a hands-on management approach that is at the investee level, to mitigate risk and deliver expected investment returns. This is consistent with several management response strategies. Oliver (1991) recommended that an

active management response strategy as a passive strategy could lead to the dominance of one institutional logic over another, and Pache and Santos (2010) advocated for internal representation of both the impact and profit logics as this will ensure paradoxical harmony.

The respondents acknowledged that some of the investee companies might have structural issues and would need technical assistance in developing processes and systems that drive ethical behaviour and enable the appropriate monitoring and review of goals set. One of the respondents in seed stage investing has invested in a business accelerator that would effectively provide the appropriate technical assistance to help mitigate risk and produce a pipeline. This is consistent with Jones and Turner's (2014) recommendation that donors and philanthropists de-risk private investments through various mechanisms, including technical assistance grants and funding for financial ecosystem developments and financial instruments, including catalytic first loss capital, debt guarantees, and other forms of blended finance.

Performance could be affected by lax risk assessment procedures, resulting in not picking-up the risks and applying appropriate controls. This observation is consistent with Stankevičienė and Čepulytė, (2014) and Statman and Glushkov (2009), who asserted that the performance could be affected by the fund manager's skill and fees. The impact strategy is important, as negative screening, stated Snider (2015), could negatively impact returns, therefore as most of the respondents actively seek high impact assets, return expectations should be market related or above. Snider stated that companies that demonstrate ESG prudence have been able to reduce risk and potentially enhance shareholder value.

6.3.5.1 Driving impact

The investment approach in Impact Investing, as stated by some of the respondents, would need the active involvement of the investors to drive impact in the investee companies. The respondents stated that this can be achieved by setting up social and ethics committees in the governance structures, or by looking through the investees' value chains to find ways of optimising impact. This will require, as highlighted by one respondent, thinking hard about impact; it is an approach that could be effective in companies that were the worst performers in terms of ESG factors, assuming that a needs analysis was performed on a company's product or service offering. The literature is skewed towards asset selection of existing high impact assets and does not talk to achieving impact in a company that possibly was not high on impact.

6.3.5.2 Governance

The respondents use the governance structure as a control measure to ensure focus at the investee level on both logics. Some of the respondents would take a seat on the Board of Directors of the investee companies to have proper oversight. Battilana and Lee's (2014) hybrid organising model has organisation design as a critical dimension, and requires a centralised structure including a governance Board that holds the organisation accountable on the basis of both logics.

6.3.5.3 Impact sectors

Some of the respondents noted that there are specific high impact sectors where there are opportunities to make high returns. In these sectors, the trade-offs, as driven by high impact risk, would be lessened by the fact that the impact is integral to the business model. Battilana and Lee's (2010) hybrid organising model captures core activities explained as an integration of activities that achieve the social and commercial objectives of the organisation. This view was supported by Brandstetter and Lehner (2015), who stated that the generation of impact should be integral to the organisation's business strategy, operations and revenue model. Perhaps in selecting a development sector one could also look at government initiatives in that sector, as government can crowd out the private sector as highlighted by one of the respondents.

6.3.6 Leadership team

The respondents not only considered value alignment as critical, but the vetting of the leadership team was also considered critical in reducing financial risk. The respondents stated that in order to incentivise the leadership team to deliver high performance in an equity transaction, they would be requested to own an equity stake in the company. Having the wrong leadership could also prove problematic when considering exiting the position and the team do not want to transfer or dilute their equity stake. Neil (2016) proposed that the best risk mitigation strategy is the consideration of the exit route on contracting and careful vetting of the sponsors. Also notable in the results was the drive from the leadership in the investee companies to embed the impact factor in decision making, which supports Luscher and Lewis (2008) who stated that emphasis should be placed on leaders maintaining equilibrium over time.

6.3.7 Millennial push

The impact space is abuzz internationally about Silicon Valley entrepreneurs who have made their millions and are now looking for opportunities to do good, and they have been cited as

one of the biggest drivers of impact (Snider, 2015). Although rich millennials are fewer in South Africa, the respondents noted that even in the workforce, this generation is driving impact. Insight could be given through research, as noted by one respondent, on how this positive energy could be channelled sustainably in driving impact.

6.3.8 Development case studies

It is important when driving capital flows in Impact Investing to be able to demonstrate some form of success. This could be in the form of track records or detailing successful exits, however, as one of the respondents explained, the impact space has seen limited exciting exits. This is a challenge that was also noted by Neil (2016), who stated that Impact Investing often involves entrepreneurs and fund managers without track records. The 2016 GIIN Annual Survey listed exit risk as the second most cited challenge in Impact Investing. Stagars (2014) also stated that impact investors are concerned about the lack of demand from the private sector, which causes illiquidity and therefore exit issues. Therefore, as noted by one respondent, perhaps the impact space need capital with high risk tolerance to be able to create liquidity and demonstrate that this investment approach is lucrative. This could be achieved, as noted by Jones and Turner (2014), by using grant funding as first loss capital in financial structures or in technically assisting small and medium size companies in order to create a pipeline and liquidity in the market.

6.3.9 Conclusion

The results revealed that there are different methods of managing the risks that come with Impact Investing, which can ultimately be integrated into a coherent investment strategy. The elements of the articulation of the investment terms in a binding contract, the risk assessment process, the finance structure, the investment and the leadership team all could be integrated in a firm's organisational design in terms of Battilana and Lee's (2014) hybrid organising model. This could be used for the investment firm to achieve an impact-return paradoxical harmony.

6.4 Research question 4

How do impact investors measure socio-environmental returns (impact returns), and is impact measurement incorporated in the overall measurement and reporting of company performance?

Measurement of impact is central to Impact Investing. In general, it is understood that you measure what you consider is important to you (Jackson, 2013; Hochstadter & Scheck, 2014). Measurement of impact could also be used to drive the impact agenda by effectively

incorporating it in the employees' performance measurement; that way it becomes central to the organisations' design and culture, consistent with Battilana and Lee's (2014) hybrid organising model. On the question of what measurement means to the respondents, the themes that appeared in the data are discussed below.

6.4.1 Impact measurement

The respondents agreed that it is important to measure impact. The measurement of impact is part of the risk management strategy as it could be used to monitor and review ESG risk and also assist in testing the effectiveness of the controls put in place. This is consistent with King and Gish's (2015) assertion that an analysis of sustainability is a continual assessment process which could be performed by practitioners to monitor the progress, strategies and evolution of ESG. The respondents discussed impact measurement under the following topics.

6.4.1.1 *Are you measuring impact?*

To gain insight into the experience gained on measuring Impact, the respondents were asked if they were measuring impact. Nine out of the ten asset managers interviewed were measuring the impact of the investments made, with one asset manager explaining that measurement of Impact is important to them, however it is only measured at investee level and not integrated at fund level. This response is consistent with the 2016 GIIN Annual Survey, which reported that 95% of its respondents believed measurement of impact is important. The most important factor, as explained by the respondents, is understanding and concise articulation of what Impact means to the investment firm. This element of establishing a corporate identity that reflects the Impact factor was included in Pache and Santos's (2013) selective coupling model. The 2016 GIIN Survey also quoted a respondent who explained that the internal communication of Impact is important to drive morale and set the tone of the culture.

6.4.1.2 *Measurement process*

The respondents also showed concern about the level at which impact is measured. One of the respondents explained that in the market, most participants are measuring impact at an output or outcome level, and therefore the measures are not a good reflection of the value of the Impact instituted. This phenomenon was noted by Jackson (2013), who stated that current practice in the measurement of Impact Investing still tends to focus on counting inputs and outputs, as well as telling stories. Jones and Turner (2014) recommended that in Impact Investing, understanding the social outcomes and impacts requires additional qualitative reviews that are not currently widespread. Jackson (2013) suggested that the Theory of Change is a great tool that could assist in pushing the field from output measurement to impact

measurement, as it would involve, as asserted by the respondents, performing a change analysis at beneficiary level by qualitatively measuring before and after the change intervention.

6.4.1.3 *Investor requirement*

The respondents were asked if the investors were interested in the reporting of Impact similar to the reporting of financial returns, and the general understanding was that impact reporting is driven mainly by the managers, and unless the company is funded by a DFI aiming at achieving specific Impact, for example job creation or B-BBEEE targeting, then the managers measure and monitor the impact as requested by Investors. The 2016 GIIN Annual Survey respondents believed measurement was important because it was part of their mission. The report also mentioned that 65% of the respondents stated that contractual commitments were another driver of impact measurement.

6.4.2 Regulatory policy

The regulatory policy that is currently topical in Impact Investing in the country is Enterprise Development, which is an element of B-BBEEE. The respondents noted that the objective behind B-BBEEE, which is economic inclusion of the previously disadvantaged, is in fact impact, however there is divergence regarding whether B-BBEEE constitutes Impact Investing. This is mainly due to the fact that B-BBEEE does not require Impact measurement, which is a critical element in the widely adopted GIIN definition of impact. Even with these concerns, Ndhlovu (2011) found that South African laws and regulations play a big role in driving sustainability in the country. On the question of whether regulating measurement would drive capital into Impact Investing, the respondents felt that regulation often creates a compliance driven (tick-box) culture that does not embrace the ethos of Impact. Haigh and Guthrie's (2010) study on regulatory reporting in New Zealand and Australia found that even when reporting was regulated, the market participants did not comply. One of the respondents also mentioned that the country runs the risk of over-regulation, as currently there is integrated reporting requirements, B-BBEEE reporting requirements, corporate governance reporting and separate financial reporting that also need to be performed. Perhaps an integrated framework is needed?

6.4.3 Reporting cost

The respondents reported that the costs of Impact measurement are significant and could, if not managed appropriately, erode financial returns, hence some of the respondents used proprietary instead of standardised metrics, as the standardised metrics include reporting of elements that are not relevant to their business. What makes the reporting costly is complexity

and time of collecting the data, which means that management is away from the business for that period of time to ensure accurate reporting. One of the respondents mentioned that the function is outsourced to consultants, creating business overhead costs. Jones and Turner (2014) agreed, stating that financial returns are straightforward to measure, whereas the measurement of social impact is much more complicated. Some respondents acknowledged the importance of measurement, but went as far as to say that perhaps the reporting costs could be a unique risk of Impact Investing. Farnen and Van De Wijst (2005) elaborated that impact Information is more difficult to obtain than financial return information, and effectively there is no way of knowing whether the assets included in an Impact portfolio are in actual effect, impactful. This could result in impact risk, and for a portfolio with capital that is earmarked for specific Impact, the manager would not be able to raise funds for the next round.

6.4.4 Measurement tools

A significant number of respondents use proprietary metrics, with only two respondents using frameworks aligned to IRIS. This is not consistent with the 2016 GIIN Annual Survey, which found an equal number of Impact Investors using proprietary and IRIS-aligned frameworks. The respondents felt that proprietary metrics were more appropriate, as they did not think that standardised metrics would comprehensively capture what they were trying to achieve. This is consistent with Haigh and Guthrie's (2010) finding that managers in New Zealand and Australia used fluid and dynamic processes, which varied over time and industry. Another factor affecting conformity in South Africa is that there is no locally developed metric, and international metrics need to be significantly adjusted to meet South African requirements. This is consistent with Van der Ahee and Schulschenk's (2013) findings that the greatest barrier to Impact Investing in South Africa is a lack of measurement tools. On the contrary, however, some respondents do not believe that a standardised metric would be useful.

6.4.5 Conclusion

The measurement of Impact is critical to Impact Investing, as the asset managers need to prove that their mission of delivering impact is, in fact, delivering Impact. The results revealed that there are concerns as to whether what is currently being measured is actually impact or if it is output. Another concern about measuring Impact is the costs involved, as impact measurement is laborious and might involve measurement tools that require information that is not readily available. The measurement tools identified are all international, and would need significant modification to be applied to the South African environment. However, as per Snider (2015), impact information is being generating and the changes in technology are making it easy to collate and report on impact.

6.5 Summary of analysis

The data collected provided rich insight into the organisational frame of Impact Investing, its challenges and its significance in capital markets. Early adopters faced infrastructural challenges which slowly dissipated with the development of a local ecosystem. Through coherent messaging and drive to generate impact, stakeholders have formed strong networks and achieved recognition from other sectors of the economy, such as the human capital markets. The concept of ESG risk redefines the risk narrative, and if it prevails, would prove to change the narrative of capitalism.

The data revealed that the question of trade-offs depends on the framing. There is no denying the immensurable risks involved in Impact Investing - some are as seen in conventional capital markets - however some are inherent not only in the impact approach, but also in other variants of the strategic positioning of the investment firm involved. The data show that it is important how one's impact is defined, as that will inform how it is measured and managed in order to reduce impact risk, which is a product of the qualitative measurement of the impact return.

It is critical for the successful execution of the impact approach to have an integrated approach to all the elements or dimensions that inform the hybrid goals of achieving Impact optimisation and return maximisation. Therefore, the answer as to whether there are trade-offs depends on the outlook of risk as conquerable by innovation, not only for financial structuring but also on the generation of impact, across all levels of the value chain. This is a new insight for organisations that wonder how they can integrate impact into their existing business model. Impact investors, as capital contributors, could be the market watch-dog for driving impact by penalising organisations that have not thought of impact.

Chapter 7: Conclusion

7.1 Introduction

The main objective of conducting this research study was to identify if there are trade-offs in Impact Investing, and if so, how they could be managed for paradoxical harmony where impact-return optimisation is achieved. The study was motivated by the fact that there is a funding gap for developmental issues, and Impact Investing stands as a viable alternative source for bridging the gap. The legitimacy of this investment approach, however, was called into question due to the combination of two competing logics. Therefore, the research contributes to the field by demystifying the trade-offs in Impact Investing.

This chapter integrates the insights gained with the existing literature to develop a model for managing the impact-return paradox at the asset manager level within the Impact Investing investment chain. The next section synthesises the findings, which are then integrated into the developed model. The implications of the findings for the asset managers are also covered, followed by implications for theory. The limitations of the research and the recommendations are discussed last.

7.2 Synthesis of research data

In examining whether there are trade-offs in Impact Investing, the findings discussed in Chapter 6 revealed that the question of trade-offs depends on the framing of risks in Impact Investing. These findings were analysed in the context of the existing literature in the framework of the questions put forward in Chapter 3. Some of the respondents identified these as risks which are consistent with conventional investing, while some thought that the challenges faced were unique to Impact Investing due to the impact-return paradox. Whichever way it is framed, there is no denying that there are challenges in achieving paradoxical harmony in Impact Investing, which is consistent in the literature that found hybrid organisations to be a locus of disorder (Pache & Santos, 2013; Battilana & Lee, 2014) and of creativity (Brandsen & Karré, 2011; King & Gish, 2015). Jay (2013) also revealed that this paradox can be managed effectively.

Hybrid organisations struggle with framing their identities and must be content with dynamism of both the internal and external environments (Brandsen & Karré, 2011; Pache & Santos, 2013; Jay, 2013). The results discussed indicated that, in forming a strategic focus, it is important to take cognisance of the environment and community one operates in to be sustainable. Therefore, it is important that when framing their strategic focus, investment firms should take into account all elements that affect their value chain, i.e. incorporation of the

operating environment, internal institutional dimensions, and investment approach, to achieve paradoxical harmony. Furthermore, it is important to define the impact and set it as an organisational goal. This finding is consistent with Pache and Santos' (2013) selecting coupling model, where they found that setting specific goals will drive organisational activities. Lastly, it is important, as the findings revealed, that there is values alignment across the Impact Investing value chain, which is consistent with Pache and Santos' assertion that there are key linkages between institutional logics and intra-organisational processes, as well as linkages between the organisation and its operating environment (Oliver, 1991).

The operating environment has enabling factors and preventive factors that might hinder the growth of the investment firm, depending on market positioning. The findings revealed that regulation at the asset manager level is a big driver of capital into the impact space. This finding is consistent with the findings of Ndhlovu (2011). The findings also revealed that government processes were found to be inhibiting growth at the investee level and therefore increase the risk for potential investors, whereas in another sector such as the renewable energy space, government is effective in crowding-in the private sector. There are other elements of the operating environment that could directly affect the asset manager's ability to effectively manage the impact-return paradox, such as macro-economic activity, the profile of investors, the available investment opportunities, and need analyses for impact.

The results showed that impact is driven by the asset managers and measured by them based on what they think is useful. The investor profile also could influence impact, as often the capital is earmarked for a specific cause. At the investee level, however, the risk exists that they might mission drift in favour of exaggerated financial returns. For this reason, it is important for the manager to first define the impact for themselves to be able to manage it effectively at the manager and investee level. This is consistent with a quote from one of the respondents to the 2016 GIIN Annual Survey on the value of driving a high impact culture internally. A crisp articulation of impact will drive other elements of the investment approach, such as measurement, asset selection and innovation. The main finding was that Impact Investing needs an active, hands-on approach in order to drive value. Specifically, the findings revealed that perhaps impact can be driven by the investor at the investee level, by infiltrating the governance structure in areas like social and ethics committees. This way, the manager is close enough to ensure that there is value alignment.

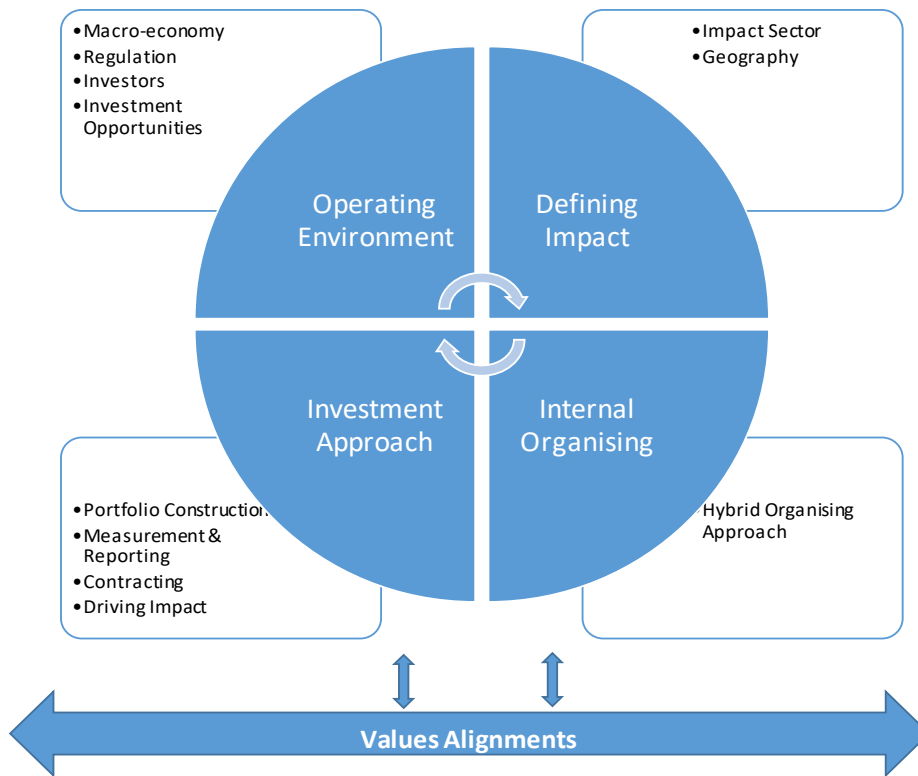
The internal organising elements of the findings were reflective of Battilana and Lee's (2014) hybrid organising model, with elements of other models discussed in Chapter 2. The five dimensions of - inter-organisational relationships, culture, organisational design, workforce composition and organisational activities - could be identified in the data. Integrating these elements could result in impact-return paradoxical harmony. The results revealed that the asset

managers are concerned about value alignment between all institutional actors across the investment value chain, as working together could drive shared value. Therefore it is important to ensure that there is alignment, specifically with capital matching opportunities, in the value chain.

7.3 The Impact-Return Optimisation Model

The model for optimising impact and return simultaneously is presented below in Figure 7. The model was developed based on the insights gleaned from the respondents as discussed in Chapter 6 above. The model is cyclic and has a feedback loop, as the operating environment is constantly changing and therefore the Impact Investing asset managers have to constantly evaluate their organisations' market positions. It starts with an analysis of the operating environment, which will inform the impact that the asset managers want to generate. The defined impact will feed into the organisation's structure and design, which will influence the investment approach. The investment approach will influence the operating environment, as the investment firm generates impact and then the loop keeps rolling in order to stay relevant and optimise the impact and return. To successfully execute this, there needs to be values alignment throughout the investment value chain, and this is evaluated and reviewed with every loop. The model also allows for the chain to begin anywhere, however it is critical to think and incorporate all elements in execution. The different dimensions of impact-return optimisation model are discussed below.

Figure 7: A model for Impact-Return optimisation in Impact Investing



7.3.1 Operating environment

The operating environment has influenced the strategic focus of the impact desired by most of the respondents' firms. Some of the respondents have gone so far as to align some of their focus impact areas to support government initiatives. Therefore, it is important to map out the operating environment, specifically to identify the socio-environmental gaps, the infrastructure that exists or is missing in the ecosystem, the regulatory environment, and the available capital that could be directed to Impact Investing. A needs analysis for Impact Investing in South Africa, due to the socio-environmental gaps in this operating environment, shows that there is an actual need for Impact Investing and that the sector has been able to raise capital, however a proper profiling of available capital needs to be performed. This will enable a capital-opportunities matching exercise to enable alignment of impact values across the chain.

7.3.2 Defining impact

Impact Investing, as defined by GIIN, requires the measurement of impact. This, as the literature reveals, not only enables asset managers to report on the impact generated, but is also a form of ESG risk analysis, and therefore could result in return optimisation if the focus is on high impact opportunities. The insight gleaned from the results discussed in Chapter 6 above revealed that it is important to articulate impact, not only for measurement purposes, but also to set a strategic focus for the investment firm. The results also revealed that to

optimise impact it needs to be contextual, that is, it needs to be informed by the environment that the investment firm is operating in. Therefore, it is important for the firm to define impact as that will enable it to set impact targets and use appropriate measurement tools. The theory of change, as purported by Jackson (2013), could be used to define impact and it will also enable relevant measurement and reporting.

7.3.3 Internal organising

Battilana and Lee's (2014) hybrid organising model proved to be insightful, as the dimensions identified were recognised in the results set out in Chapter 6. The model refers to the integration of all the five dimensions in achieving paradoxical harmony of impact and return in a hybrid organisation like an Impact Investing firm. The five dimensions, as set out in Figure 4 in Chapter 2, are inter-organisational relationships, culture, organisational design, workforce composition and organisational activities. Internally, there needs to be a common goal recognised by all insitutional actors, whose values are aligned with the organisation's values. This means that the recruitment policies and employee performance frameworks need to incorporate the companies' values. Furthermore, this should be reflected in the organisational culture.

The results also revealed that the corporate identity or company messaging could be a great tool not only for attracting the right people, but also for attracting investors. The right internal organising also refers to structural organisation. This will involve consideration of the legal structure, revenue generation structure for the asset managers (how fees are earned), cost management at fund level, and internal compensation. The conventional financial performance structure might not be ideal for Impact Investing as it will drive the wrong culture and exacerbate trade-offs by optimising financial return and sacrificing impact.

7.3.4 Investment approach

The results revealed that the managers can be protective of the strategy instituted when making investment decisions, even though the asset managers might end up investing in the same company. This could partly be because of the limited investment opportunities. Impact optimisation with a lucrative commercial business model could be achieved by reviewing the business processes and its value chains to find ways of generating and optimising impact. There are examples of organisations that have generated impact from a previously purely commercial business model. This could be driven by the investors, therefore it is a possible investment approach that the asset managers could institute.

The finance structuring approach in the South African impact space is binary, with some blending and debt trenching activity. Guarantees and grant funding have been used as first

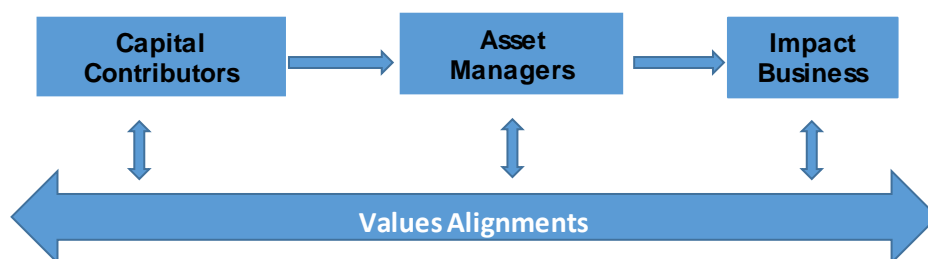
loss capital, however more of this is needed to fully open the market to taking on risk and optimising impact. There are other innovative finance structuring models that could be adopted from international markets, which could be useful in mitigating risk and optimising returns.

The results revealed that rigorous risk assessment procedures, targeted at all aspects of the investment, could reveal all risks and assist in the development of appropriate interventions to mitigate these. Involvement in the investees' corporate governance structures to drive impact has been identified as a useful tool for impact-return optimisation. The portfolio construction process has also been identified as a tool for managing the impact-return paradox, whereby the expectations at deal level are low based on impact-return levels at portfolio level. Therefore, this could be a good avenue for achieving impact-return optimisation.

7.3.5 Values alignment

Several actors have been identified as critical constituents, driving the trade-offs of the impact-return paradox across the value chain. These are the capital contributors and the leadership teams of the target companies. The respondents mentioned that the investment opportunities could be limited by the lack of target companies with a leadership whose values are aligned with their values. On another hand, the capital contributors' bucket is limited to investors aiming for high risk-adjusted returns and there are unwilling to take-on risk. This situation could be a trigger of trade-offs which could increase impact risk. Therefore, for a harmonious impact-return paradox, the values across the Impact Investing value chain should be aligned. The legal contract should reflect both impact expectations and financial performance measures to ensure that all stakeholders are accountable for their end of the value chain. The below figure shows the value alignment across the Impact Investing value chain:

Figure 8: Alignment across the value chain in Impact Investing



7.4 Implications for theory

This research contributes to the institutional theory on managing competing logics, paradox theory and the developing theory on hybrid organisations. The impact-return optimisation model combines literature on hybrid organisations, paradoxes and competing institutional

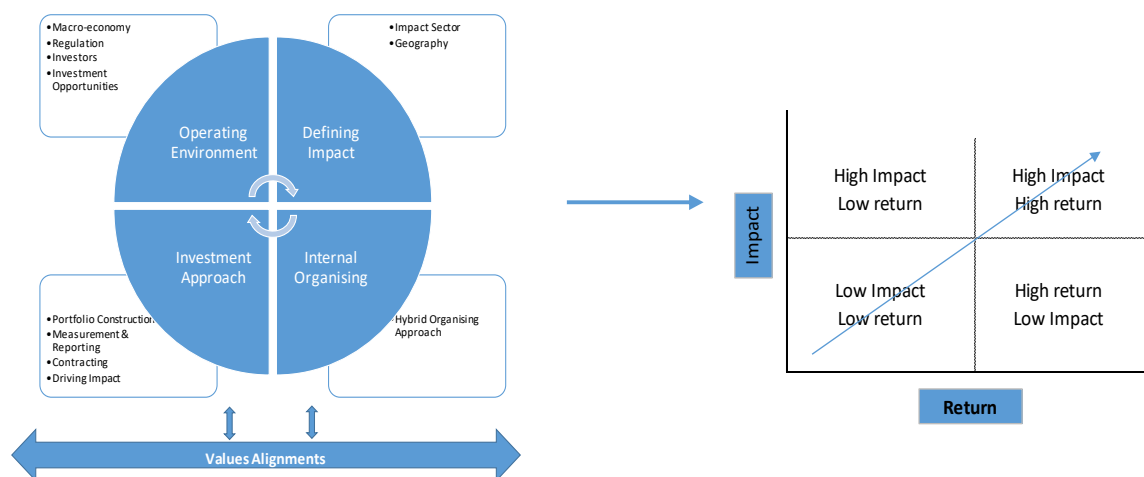
logics in analysing Impact Investing. The optimisation model, unlike the models identified in Chapter 2, comprehensively integrates the external and internal environments in managing the impact-return paradox, and this is the first model specifically designed for Impact Investing.

The approach in the literature of assessing the trade-offs in Impact Investing has been to perform empirical studies on the difference in performance of conventional investment portfolios against impact investment portfolios based on listed companies. Yet these studies ignored that the impact market has a majority of unlisted assets; the 2016 GIIN Annual Survey revealed that impact investors ranked liquidity and exits as the second highest contributors to investment risk. Therefore, this research contributes to theory by specifying contributors to trade-offs in Impact Investing, and by describing how the optimisation of Impact and Return can be achieved for a harmonious paradoxical existence.

7.5 Implications for asset managers

Asset managers are currently wedged between maximising financial returns for their investors and executing an impact mandate, which is driven mainly by the investment team as highlighted in Table 8. However Table 16 lists some of the factors that could be used to mitigate risk in order to optimise both impact and return. A diagnosis of the current investment firm set-up, against the impact-return optimisation model in Figure 7, is needed in order to determine the current position of the firm against the model. Once a diagnosis is given, the Impact Investing asset manager can then assess the path towards an integrated approach of achieving impact-return optimisation. This process is reflected in the below diagram, where the diagnosis reveals which quadrant the manager is in, and then the impact-return optimisation model can be used to achieve optimisation, i.e. the High Impact – High Return quadrant.

Figure 9: Moving to impact-return optimisation



If the asset manager's diagnosis reveals that the manager is in the quadrant of high-impact and low return, the manager could review the investment approach relative to the operating market to identify available resources that could assist in de-risking and framing the business model to optimise the return with the impact, and move to the high impact, high return quadrant.

If the manager's diagnosis reveal that the manager is in the quadrant of high return and low impact, the manager could review the investment approach and how impact could be achieved within the current investment value chains, specifically at the investee companies, without compromising the returns.

Should the diagnosis reveal that the manager is in the quadrant of low return and low impact, the effective response would be to start with the definition of impact within a commercial context, which will entail a review of the critical business activities and how those are performed in order to assess effectiveness of systems put in place. Then the impact-return optimisation model should be followed in framing organisational goals and how they could be achieved in order to optimise impact and return.

The critical element in the current fund structures is value alignment across the investment chain and ensuring that performance is measured based on the integrated approach. It is critical for the managers to match capital with respective impact investment.

7.6 Recommendations for impact businesses seeking funding

The results of the study revealed that asset managers are concerned about the fact that there are not enough opportunities in the market that meet their investment criteria, but on the other hand the impact businesses complain about a lack of funding opportunities. Therefore, the insights gleaned from this research are that the impact businesses need to present the following to the asset managers:

- A sustainable growth model, proving the financial viability of the business idea. This is important as the asset managers revealed concerns over financial risk, and the majority of them expected a market related, risk-adjusted return.
- A credible impact case, detailing exactly how they are generating impact. They must be able to show how they measure impact and that they are committed to generating sustainable impact. This is because the managers stated that when constructing a portfolio, they look first at the risk and then at the impact that is aligned with their mission.
- A track record to prove that the business has had some success in proving the market viability of the investment idea and the feasibility of their business model. Also, they

need to be in a growth phase, i.e. they need a capital injection to expand. This is because the asset managers revealed that to manage risk, they need some stability and assurance from the business opportunity.

- The asset managers revealed that a critical part in the risk assessment process is the assessment of the business leaders, therefore the team needs to have a coherent leadership, taking cognisance of the corporate governance requirement with critical business process managers in place. An example of this is a qualified financial officer to ensure that there are controls in place for cash flow management. Furthermore, it is critical for the leadership to show their commitment to not only achieving financial growth, but also to achieving impact and showing a commitment to measuring it.

7.7 Limitations of the research

The potential limitations identified for this research were:

- the research study was limited to experts and practitioners based in South Africa, and therefore their views may have been contextually biased to their operating environment;
- the research is based on non-probability sampling of 15 professionals of an unknown population, therefore it had inherent limitations of non-probability sampling regarding population representation. Furthermore generalisation might be a concern (Saunders & Lewis, 2012);
- purposive sampling is based on the judgement of the researcher, and therefore sample bias was a concern as the researcher's views and beliefs might have impacted the sample selection;
- due to the intimate setting of the in-depth, semi-structured interviews, there were concerns regarding data analysis bias as the researcher's views, beliefs and experience might have affected the data analysis or resulted in a loss of contextual meaning; and
- the researcher has no formal training on the dynamics of performing social interviews for research purposes, therefore there is a risk that the researcher's skill and experience in interview process management and application of probing techniques to solicit the desired insights were limited.

7.8 Recommendations for future research

- The results revealed that an investment pipeline is an issue as there are not a lot of investment ready, high impact, companies. This is true even with numerous government and private sector small business accelerators that have the objective of helping the development of small business. Therefore, there is a gap in the market in terms of what the investment organisations consider ‘investment ready organisations’ and what the accelerators consider ‘investment ready organisations’. An analysis should be performed with the aim of bridging the gap between investors and business consultants, to ensure delivery of high impact-return business for investment.
- There is wealth of investment capital in the South African market, however it is not targeted at the right investment opportunities. This varies from government grants, Development Finance Institutions (International and Local), corporates, high net-worth individuals, foundations (international and local) and institutional investors. A study should be performed to try to match capital with the right investment opportunities, based on impact values and expected investment return. This will alleviate some of the trade-off challenges encountered by the asset managers in making investment decisions.
- A study should be performed on innovative finance structures that could be useful in de-risking investment portfolios and allowing for impact optimisation.
- The millennial generation were identified in this study as drivers of impact throughout the Impact Investing value chain. Research should be performed on this generation in order to understand its motives and values, its contribution to the value chain, and its impact-return expectations, as this will shape the business environment of the future.
- Impact measurement is currently focused on inputs, and no work has been done on the viability of measuring at the impact level and if the impact is sustainable. Research should be performed to develop standards, which could be adjusted to meet contextual demands and are cost effective, on measuring impact and its sustainability at the Impact or beneficiary level.

7.9 Conclusion

There is no doubt that not only is Impact Investing transforming the field of finance, but it could potentially reshape the business landscape as companies start being assessed on their impact before investment decisions are made. The investment strategy, however, has challenges that cause trade-offs, which when specified could be framed as risks and managed accordingly.

There are case studies that prove that an integrated approach is possible if resources are merged as shown in the impact-return paradox.

The research identified that:

- there is a need to identify the right capital for the right investment opportunity. This way value alignment is achieved and return and impact can be optimised;
- an active investment approach is needed in order to drive impact at the investee level. This approach means that high impact could also be driven perhaps to a previously pure commercial entity if the need analysis is justified for the product or services offered; and
- reviewing and monitoring of impact and optimising it could optimise financial returns as this would mean a reduced ESG risk. This element could be critical in a millennial world, as their views will eventually reshape the business environment to look at impact as a need to have and not a nice to have.

The impact space has exciting implications for emerging or frontier markets as the private sector invests in development. This provides hope for at least half of the world's population who live below the poverty line. The results of this research will contribute to the success of Impact Investing in emerging markets like South Africa.

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Appendices

Appendix 1: Interview Guide

Introductory question:

1. What are the portfolios held and respective values?
2. Is the company targeting a specific geographical area and why?
3. What inspired the impact investment strategy?
4. Is there a specific social or environmental Impact that the interviewee or Investment Company want to change?

Cognitive Frame

5. Should the interviewee represent an institution, what are the company values and are these linked to Key performance indicators?
6. What is the most important factor when recruiting? Are values considered?

The investment process

7. What drives investment flows, past returns or non-financial factors?
8. How is risk assessed?
9. Are there unique risk factors with Impact Investing?
10. How are risks mitigated?
11. How is the balance between socio/environmental Impact and financial return achieved?

Investment return expectations

12. Are you willing to make an investment with a return that is 20% lower than conventional funds for the sake of impact?
13. Are you willing to make a 20% loss on your investment?
14. Does the investment mandate or risk-assessment procedures have a loss limit?
15. From your experience, what are some of the returns have you had to give up due to non-financial (impact) factors?

Assets selection

16. How is the investment portfolio constructed? How are assets selected?
17. Does size and ownership structure of the target entity matter?
18. Do you purely select ethical or socially responsible investments? Or is the portfolio mixed with other assets in order to diversify?

Performance Measurement

19. How is the financial return measured?
20. How is the social return measured?
21. What benchmarks are used to track performance?
22. How is the return monitored, reviewed and reported?

23. Does government, policy or regulation play a role in driving Impact Investing

Appendix 2: Participant Consent Form

Participant Informed Consent

I am conducting research on the paradox of Impact Investing, which is defined as 'Investments made into companies, organizations, and funds with the intention to generate social and environmental impact alongside a financial return'. I am trying to understand the trade-offs in decision making when Investing for Impact if any and how they can be better managed in-order to derive shared-value.

Your personal views and experience on the subject will be invaluable in helping us understand how best to manage the impending conflicts of financial returns maximisation and addressing socio/environmental ills. The interview will last approximately forty-five minutes and will be recorded in audio format with your consent. All data will be kept confidential and no comments will be linked back to any interviewee as the information gathered will be used in aggregated form.

Your participation is voluntary and you can withdraw at any time without penalty. If you have any concerns, please contact my supervisor or me. Our details are provided below.

Researcher name: Matlhogonolo Mogapi

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Signature of Participant: _____ Date: _____

Signature of Researcher: _____ Date: _____

Appendix 3: Ethics Acceptance Letter

Dear Eunivicia Matlhgonolo Mogapi

Protocol Number: **Temp2016-00948**

Title: **Trade-offs in decision making by impact investors between socio/environmental return and financial return**

Please be advised that your application for Ethical Clearance has been APPROVED.

You are therefore allowed to continue collecting your data.

We wish you everything of the best for the rest of the project.

Kind Regards,

Adele Bekker

Appendix 4: Consistency Matrix

Proposition/Questions/Hypothesis	Literature review	Data Collection tool (Interview guide)	Analysis
What factors do impact investors consider when constructing an investment portfolio?	<ul style="list-style-type: none"> • (Benson & Humphrey, 2008) • (Derwall, Koedijk, & Horst, 2011) • (Lewis, 2001) • (Renneboog, Horst, & Zhang, 2008) • (Webley, Lewis, & Mackenzie, 2001) 	<p>Question 4 Question 16 Question 17 Question 18</p>	
What are the trade-offs of Impact Investing?	<ul style="list-style-type: none"> • (Brandsen & Karré, 2011) • (Derwall, Koedijk, & Horst, 2011) • (Glac, 2009) • (Webley, Lewis, & Mackenzie, 2001) 	<p>Question 7 Question 8 Question 9 Question 10 Question 23</p>	
How do impact investors achieve the balance between the competing logics of profit maximisation and socio-environmental Impact	<ul style="list-style-type: none"> • (Battilana & Dorado, Building Sustainable Hybrid Organizations: The case for commercial Microfinance organizations, 2010) • (Brandsen & Karré, 2011) • (Brandstetter & Lehner, 2015) • (Klettner, Clarke, & Boersma, 2014) • (Luscher & Lewis, 2008) • (Pache & Santos, Inside the Hybrid Organisation: 	<p>Question 5 Question 6 Question 11 Question 23</p>	

	<p>Selective Coupling as a response to competing instituional logics, 2013)</p> <ul style="list-style-type: none"> • (Smith & Lewis, 2011) 		
<p>How do impact investors measure socio-environmental returns (impact returns), and is impact measurement incorporated in the overall measurement and reporting of company performance?</p>	<ul style="list-style-type: none"> • (Bauer, Otten, & Rad, 2006) • (Bilbao-Terol, Arenas-Parra, & Canal-Fenandez, 2012) • (Galema, Plantinga, & Scholtens, 2008) • (Jackson, 2013) • (Reenneboog, Horst, & Zhang, 2008) 	<p>Question 19 Question 20 Question 21 Question 22</p>	

Appendix 5: Originality Report

Attached is the first five pages from Turnitin originality report: