

# The Development of Impact Investing and Implications for China

By

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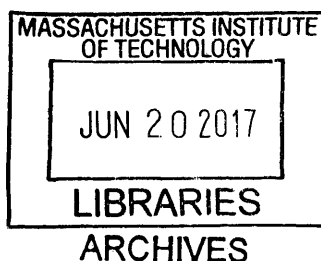
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# **The Development of Impact Investing and Implications for China**

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## **ABSTRACT**

In recent years, impact investing has been developing rapidly and attracting broader attention. According to the JP Morgan and GIIN *Annual Impact Investor Survey*, the number of global impact investors increased approximately eightfold between 1995 and 2015. While still facing challenges and competition, impact investing represents a significant trend in investment. The concept was brought to China several years ago but is still at an early stage. This paper will discuss the development and features of impact investing, with an analysis of and comparison with the Chinese market, to propose suggestions for its future development.

The research in this paper is based on the analysis of recent publications and industry reports, impact investing case studies, and interviews with impact investors and social enterprises. The study also includes analysis of the limitations and difficulties of impact investing globally and in China, with suggestions for future development.

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# Chapter 1: Introduction to Impact Investing

The concept of impact investing was first introduced in 2007. In 2010, JP Morgan and the Rockefeller Foundation issued a joint research report titled *Impact Investments: An Emerging Asset Class* (J.P. Morgan Global Research, Rockefeller Foundation, 2010). It defined impact investing as a separate asset class that differs from mainstream investments and was projected to grow rapidly in the next ten years. Since then, impact investing has received broader attention from both investors and social enterprises. Along with its development, more researchers argue that it is not an asset class but rather an investment approach. What is impact investing? What is its global development? This chapter will address such questions.

## 1.1 The Definition of Impact Investing

According to the Global Impact Investing Network (“GIIN”), impact investments are investments “made into companies, organizations, and funds with the intention to generate a measurable, beneficial social or environmental impact alongside a financial return”<sup>1</sup>. In its 2013 report, the World Economic Forum defines impact investing as “an investment approach that seeks to both create financial return and positive social or environmental impact that is actively measured”<sup>2</sup>. In this definition, the Forum emphasized that impact investing is an investment approach

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<sup>1</sup> <https://thegiin.org/impact-investing/>, Global Impact Investing Network website

<sup>2</sup> World Economic Forum. (2013). *From the Margins to the Mainstream Assessment of the Impact Investment Sector and Opportunities to Engage Mainstream Investors*.

instead of an asset class, and impact investing addresses three important elements: 1) the investment achieves financial return, 2) the investment has positive social or environmental impact and 3) the financial return and social impact are measurable.

Under this definition of impact investing, any means of investing that pursues and measures financial return and social impact should be considered impact investment. However, although some corporations invest in socially beneficial projects aiming to achieve both social impact and financial return, this kind of investment is usually labeled as corporate social responsibility (CSR) instead of impact investing (we will discuss the differences between impact investing and CSR later in this chapter). The scope of impact investing is limited to the investment approaches applied by financial intermediaries across all financial asset classes with the intention to generate positive social impact.

Impact investment assets are usually managed under impact investing funds, and allocated into different asset classes, including private debt, public debt, private equity, public equity, deposits, and cash among others. For example, Leapfrog Investments is an impact investor supporting the finance and healthcare development of Africa and Asia through equity investment; Wellington Global Impact Fund invests in public stocks of companies that intend to generate social and environmental change. Some other impact investment assets are managed through impact bonds, like the International Finance Corporation (IFC)'s USD 4.3 billion three-year AAA-rated green bonds, which provide financing for projects solving

greenhouse gas emission environmental problems<sup>3</sup>. Generally speaking, impact investing is not a unique asset class, but an approach to selecting and investing in entities with positive social and environmental impact through all kinds of asset classes.

## 1.2 The Features of Impact Investing

Impact investing is unique from other investment approaches because it pursues both financial return and measurable social impact.

### **1) Financial return**

Impact investing creates and measures financial returns. Similar to commercial investors who have different tolerances for risk and invest through different channels to achieve different return rates, impact investors have different expectations on return rates. The expectations of return rates vary from capital preservation to above market return rates. The *GIIN Annual Impact Investor Survey* (GIIN, 2016) shows that approximately 59% of investors primarily target risk-adjusted market returns, 16% of investors target returns that are close to capital preservation, and the others are in between<sup>4</sup>.

The different expectations of return rates are affected by investment strategies. Investment strategies are developed at the outset and are used to guide the deal

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<sup>3</sup> *Overview of IFC's Green Bonds*. Retrieved from [http://www.ifc.org/wps/wcm/connect/corp\\_ext\\_content/ifc\\_external\\_corporate\\_site/about+ifc\\_new/ifc+governance/investor+relations/grnbond-overvw](http://www.ifc.org/wps/wcm/connect/corp_ext_content/ifc_external_corporate_site/about+ifc_new/ifc+governance/investor+relations/grnbond-overvw)

<sup>4</sup> GIIN. (2016). *Annual Impact Investor Survey*.

sourcing and investments. Impact investors will balance their acceptable risks, select industries or social problem focal areas, and determine acceptable financial return rates. Some investors are willing to bear higher risks and compromise financial returns for larger social impact, like DRK and China Impact Ventures, which invest in early stage companies and are flexible in financial return expectations. Some investors invest at a later stage and target the market return rate, of which Bain Capital Double Impact and Double Bottom Line Venture Capital are two examples.

It has not been proven that there is a trade-off between financial return and social impact. Benchmark analysis shows that impact investments targeting a market return rate also generates strong financial returns comparable to conventional investments, and mission-driven investors have a greater chance of a successful exit. Although this analysis is based on a limited sample size which may not be representative, it proves the possibility to achieve both social and financial returns without compromising either. But this does not mean that all impact investors should pursue market returns or that philanthropy should not exist. There are still some social problems that cannot be effectively solved with a combination of high financial and social returns, for example, the lack of basic living infrastructures in rural Africa, where philanthropies like the Gates Foundation play an important role in solving these problems.

## ***2) Social impact and impact measurement***

Impact investment differs from commercial investment in its intention to achieve positive social impact and the continuous measurement of the impact. Positive social impact refers to the improvement of one social problem after

implementing the solution compared with what would otherwise be without the implemented solution, known as “additionally”. For example, if a company produces a medicine to cure an infectious disease, the decrease in the infection rate itself cannot prove the impact unless it proves that the infection rate is less than that of a comparable community not taking the medicine.

Impact measurement should be integrated into the whole investment management process. It includes identifying impact goals, developing impact matrix, collecting and analyzing impact data, and reporting achieved impact. Before the investment, impact investors usually screen the scope and achievability of the expected social impact. To identify the achievable impact, investors work with entrepreneurs to develop the Impact Value Chain, which includes six aspects: input, activity, output, outcome, and impact, to understand how the impact will be generated from the company’s activities. Besides the impact goal, risks of whether the impact can be continuously achieved along with the company’s development are also evaluated to make investment decisions. Then, an impact matrix composed of short-term and long-term measurable key performance indicators (KPIs) is developed and continuously tracked. Take the medicine company’s example: KPIs may include the number of people recovered from the disease, the infection rate, the death rate of infected patients, and even the number of jobs provided. KPIs in the matrix should be timely tracked and analyzed, so that fund managers can provide timely intervention of investee companies and report to limited partners and potential investors about the achieved social impacts.

To evaluate the social changes generated by the company and to calculate the expected social returns when the company scales the business, a few known measurement methodologies are developed and widely applied, including the Impact Reporting and Investment Standards (IRIS) matrix, the Global Impact Investment Ratings and Standards (GIIRS) and the Social Return on Investment (SROI). Currently, there are no standard regulations about impact measurement, and some companies develop their own methodologies to measure the impact. Impact measurement reporting currently relies on self-reporting, and there are no auditing or verification requirements.

### ***3) Comparison with commercial investment, philanthropy, and SRI***

The wide range of expected return rates and lack of standardized impact measurement sometimes blur the boundary between impact investing and venture philanthropy, socially responsible investment (SRI) and commercial investing.

Venture philanthropy is another investment approach that combines charity into venture capital investment in order to achieve sustainable and scalable social impacts. From the investment perspective, venture philanthropy investment is closer to a philanthropy donation, because it does not aim to achieve profit but rather to make positive social and environmental impacts by taking higher risks in early-stage ventures or organizations; however, it differs from charitable donation in that it considers more heavily whether an investment can be used to generate expansion and sustainability of social impacts rather than whether the charity recipient is

eligible for the donation objectives<sup>5</sup>. Venture philanthropy was mostly active in the mid to late 1990s as a new model of philanthropy to attract non-philanthropic investors and to promote the effectiveness in grants<sup>6</sup>. Venture philanthropy can be for-profit or non-profit, and funding comes from both donors and private sectors. It usually lasts longer (usually 5-7 years) and aims to fund less popular social causes with inferior projections regarding financial returns. We can recognize that impact investing developed from venture philanthropy to a broader scope with more consideration of financial sustainability. Some philanthropy ventures nowadays are changing their investment scopes from pure philanthropy to for-profit impact investing. Draper Richards Kaplan (DRK) Foundation is one example.

SRI refers to investments with the purpose of achieving financial returns but avoiding investing in companies or industries that have a negative impact on society or the environment, such as tobacco or gambling. Different from impact investing investors, who continuously measure social impacts, SRI investors instead usually perform positive or negative screening to avoid harmful effects. SRI is considered to be interrelated with impact investing in consideration of social impact, but it takes a passive approach<sup>7</sup>.

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<sup>5</sup> Social Enterprise Research Center. (March 2013). *China Social Enterprise and Impact Investment Report*.

<sup>6</sup> *5 Venture Philanthropy Fund and Networks to Check Out*. (March 2013). Retrieved from <http://www.socialenterprisebuzz.com/2013/03/12/5-venture-philanthropy-fund-and-networks-to-check-out/>

<sup>7</sup> Social Enterprise Research Center. (March 2013). *China Social Enterprise and Impact Investment Report*.



Commercial investments are usually purely profit-driven, and social impact is not generally considered. There are now quite a few companies targeting social and environmental problems that achieve profitable financial return due to adoption of the right business model as well as huge market demand. These companies attract investment from both commercial investors and impact investors, causing overlap between these two investment approaches.

*Table 1 Comparison of Impact Investing, Venture Philanthropy, SRI and Commercial Investment*

High expectation		Requirements on Social Impact		Low expectation	
Low expectation		Requirements on Financial Return		High expectation	
<b><u>Venture Philanthropy</u></b>	<b><u>Impact Investing</u></b>	<b><u>Socially Responsible Investment</u></b>	<b><u>Commercial Investment</u></b>		
Aims to generate sustainable social or environmental impact, with no or few requirements on financial return	Aims to achieve both financial return and positive social and environmental impact	Avoids negative impact on environment and society while achieving financial return	Aims to generate financial return, with few considerations about social impact		

Impact investing, venture philanthropy, SRI and commercial investment differ and overlap with each other in their expectations of financial return and social impact. Impact investing sits between pure philanthropy and commercial investment with a mindset of both social impact and financial return. It is usually believed that impact investors are more willing to give up financial returns in order to achieve larger social impacts compared with SRI investors and commercial investors, but it is not proven that investors have to sacrifice financial return for social impact. On the

other hand, the financial returns are considered to be crucial for creating sustainable impact, and some studies show that investments in sustainability often meet or exceed the performance of comparable commercial investments. As a result, several commercial investors have started to raise and manage impact investing funds. For example, Bain Capital launched Bain Capital Double Impact in 2015. It seems to be a trend that more and more commercial investors are gradually accepting the concept of impact investing and considering the social impact in their investments.

### 1.3 Global Development of Impact Investing

Impact investing was originated in the United States and Europe and then expanded globally. With over 75% impact investing funds headquartered in the U.S. and Europe, impact investors invest 63% of the asset under management (AUM) in other parts of the world, including Africa, South America, and South Asia<sup>8</sup>. The capital is provided by pension funds, insurance companies, governments, developed finance institutions (DFI) and high-net-worth individuals, investing mainly in housing, finance, and energy sectors (around 60%) mainly in growth or later stage companies (around 82%)<sup>9</sup>.

Currently, impact investing is in a developing stage with a growing trend in both the number of impact investors and the AUM. According to the *Annual Impact Investor Survey* (GIIN, 2016), the number of impact investors has been growing steadily in the past two decades, and the AUM of existing impact investors increased

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<sup>8</sup> GIIN. (2016). *Annual Impact Investor Survey*.

<sup>9</sup> GIIN. (2016). *Annual Impact Investor Survey*.

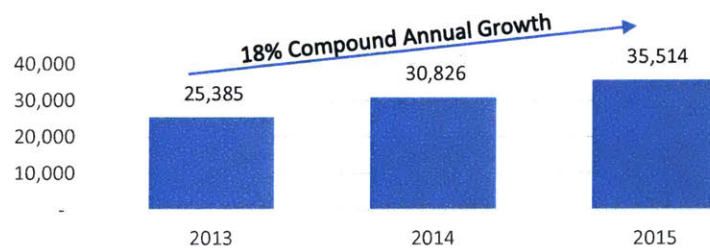
at a 18% compound annual growth rate from 2013 to 2015, showing a rapid growth of the market.

**Figure 1: Year of First Impact Investment**



Sources: Annual Impact Investor Survey (GIIN, 2016)

**Figure 2 Total AUM by Year (in USD millions)**



Sources: Annual Impact Investor Survey (GIIN, 2016)

Although the impact investing AUM reported in the 2016 GIIN Impact Investor Survey (GIIN, 2016) is over USD 77.4 billion for 156 investors, the scale of impact investing is still small compared to commercial investing. Currently, there is no special registration requirement for impact investors, thus we do not know exactly how many impact investors are out there in the world. However, the AUM of active

private equity funds reached USD 4.2 trillion in June 2015<sup>10</sup>, and AUM of pension funds, insurance companies, and mutual funds was around 80 trillion in 2011<sup>11</sup>. We can conclude that impact investing is still only a tiny fraction of commercial investment, and that there is still a long way to go for impact investing to become mainstream.

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<sup>10</sup> Preqin. (2016). *2016 Preqin Global Private Equity & Venture Capital Report - Sample Pages*. Retrieved from [https://www.preqin.com/docs/reports/2016-Preqin-Global-Private-Equity-and-Venture-Capital-Report-Sample\\_Pages.pdf](https://www.preqin.com/docs/reports/2016-Preqin-Global-Private-Equity-and-Venture-Capital-Report-Sample_Pages.pdf)

<sup>11</sup> TheCityUK - Fund Management 2012

## Chapter 2: Impact Investing in China

Impact investing was brought to China from the U.S. and the U.K. in the late 2000s. In 2012, China had its first Social Investment Forum with more than 200 attendants. In 2016, the number of attendants to the Social Investment Forum grew to over 1,000. Impact investing in China is still at an early stage, but it raised a growing attention and developed its own characteristics. In this chapter, we will introduce the development of impact investing in China and its unique characteristics different from global impact investing.

### 2.1 The Social Environment and Major Social Problems

China has been developing fast in the recent two decades. With an average annual GDP growth rate of around 10% in the past 25 years, China has achieved an annual GDP per capita of USD 6,500 in 2016. However, this number was still only one-eighth of that of the United States, whose per capital GDP was USD 51,638 in 2015<sup>12</sup>. Also, China's economy is unevenly distributed: the richest city achieved over USD 35,000 GDP per capita in 2015, while the poorest province had only less than USD 4,000 (not to mention the villages under extreme poverty in poor provinces)<sup>13</sup>. Although China has lifted over 800 million people out of poverty since 1987, there are still over 50 million Chinese living in poverty today.

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<sup>12</sup> [www.tradingeconomics.com](http://www.tradingeconomics.com)

<sup>13</sup> <http://finance.qq.com/a/20170227/070364.htm>

In order to solve the poverty problem, China boosted its economic development through massive industrialization in the past several decades. Along with the economic development, the country's accumulated wealth encountered more and more social problems at the same time: the environmental deterioration due to unsustainable development, a lack of high-quality education to provide skillful labors, uneven distribution of wealth among different social classes, food and drinking water safety problems, air pollution and so on. These social problems gradually attracted attention, but none of them can be easily solved in a short period of time by the government only.

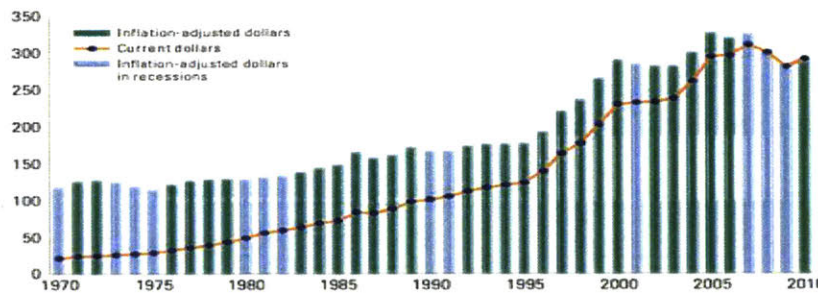
Under this social environment, and also influenced by the social responsibility concept from the Western countries, China started to care about the social problems, and began to support foundations and organizations to solve social problems together. However, the development of social responsibility in China is affected by several factors:

### ***1) Economic development***

The development of charitable activities is related to economic conditions. From the development history in the United States, we can draw a linear correlation between charitable giving and the economy (GDP per capita). In the US, the amount of charitable giving surged in 1995 when the annual GDP per capita reached around USD 29,000, a level that is four times higher than China.

Also, the increase of GDP per capita leads to an increased portion of wealth for donation. In 1975, charitable giving was around USD 125 billion, 1.5% of the GDP, while the percentage increased to around 2% to 2.3% in the 2000s<sup>14</sup>.

**Figure 3 Charitable Giving in the U.S. (in USD billion)**



Sources: <https://npengage.com/nonprofit-fundraising/5-interesting-facts-from-the-giving-usa-2011-report/>

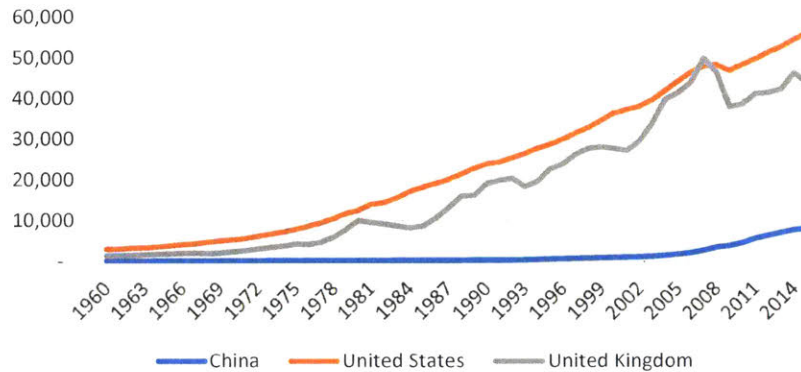
From the historical economic data, we can see that China's current GDP per capita is around 40 years behind the U.S. and 30 years behind the U.K.. This may be the main reason that charities and social impact activities in China are still lacking behind in broad public awareness. However, the proportion of charitable giving to GDP in China is also much lower: in 2015, total donations in China amounted to around USD 10 billion, which is only 0.1% of China's GDP<sup>15</sup>. Although the data collection may not be accurate or consistent between China and the U.S., the difference in donation rate is so significant that there must be other factors besides the economy that caused this discrepancy. Other reasons may be that the less developed social security system did not give people the mentality to donate, or

<sup>14</sup> Giving Statistics, <https://www.charitynavigator.org/index.cfm/bay/content.view/cpid/42#>

<sup>15</sup> Data from Nation Bureau of Statistics of China, <http://data.stats.gov.cn/search.htm?s=GDP>

because the education curriculum did not include enough social responsibility related topics.

**Figure 4 GDP per Capita – US, UK and China (USD)**



Sources: World Bank database

## **2) Culture awareness**

In the U.S. and the U.K., the culture of sharing and giving is embedded in the tradition through religion. Studies have shown that around two thirds of individual donations in these countries are through churches. While in China, religions are not supported by the government, and most people do not have a faith.

In China, there are traditional cultures to care about the society and to help each other, but some of these cultures have been lost during the Culture Revolution from 1966 to 1976. During the Culture Revolution, wealthy people were considered capitalists and their fortunes were taken away and redistributed to the poor. People who experienced the Culture Revolution were in fear of being attacked or criticized as capitalists and learned to hide their wealth for a long time. Helping the poor and solving social problems were considered the government's responsibility, as such



the allocation of wealth was planned by the government, including allocation of jobs, food, clothes, and so on. This special history in China took away people's awareness to give and help others in need.

After China had revised its policy of communism into socialism, it allowed a portion of the citizens to become rich first and then support the others in need, and charitable organizations started to grow. Even still, people's mentality was still affected by the criticism of capitalism, and the majority believed that social contribution should be pure donation rather than gaining any profit. Only in recent decades, some individuals started to establish social enterprises to solve social problems under a for-profit business model, and it took China a long time to define and accept the concept of social enterprises.

### ***3) Government supports and the regulation environment***

In China, the government was the major driver to develop the society and to solve issues before the 1990s. The economy developed in an unsustainable way and caused more and more social and environmental problems. Until 1992, the Chinese government was inspired by the National Union Conference on Environment and Development (UNCED), and set sustainable development as a nationwide development strategy in 1996<sup>16</sup>. In the new century, the government passed a series of regulations to achieve sustainable development: it established and completed environmental protection regulations and implemented the supervision systems; set

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<sup>16</sup> *China Sustainable Development Report*. (n.d.). Retrieved from <http://www.china-un.org/chn/zgyllhg/jsyfsz/kccfz/P020120608811375491670.pdf>

policies that supported the development of rural areas in western China and financed the growth of new energy industries; improved the education awareness through media and educational institutions; and encouraged non-government organizations, foundations, and the general public to participate in sustainability activities. The government also increased communication and co-operation with other countries on sustainable social initiatives.

The encouragement of organizations to help with solving social problems led to a fast development of charity foundations and social enterprises, which play an important role in tackling social issues. By the end of 2014, there were around 1,400 foundations established by the government and over 300,000 NGOs and private foundations<sup>17</sup>. Tax exemptions are provided to the companies and individuals who donate to non-profit organizations: companies' donation can deduct up to 3% of taxable income for income tax purposes (except financial institutions, which enjoys a tax deduction limited to 1.5% of taxable income), and individuals' donation can be deducted up to 30%.

However, this tax benefit is relatively conservative in comparison to that of most developed countries. In the US, for example, companies can deduct up to 10% of taxable income and individuals can deduct up to 50%. The tax deduction scope is also very limited in China: the donations are only tax deductible when they are donated to officially filed foundations, while registration for an officially filed

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<sup>17</sup>

[http://c.ymcdn.com/sites/www.advisorsinphilanthropy.org/resource/resmgr/china\\_conference/liwei\\_wang\\_chinese.pdf](http://c.ymcdn.com/sites/www.advisorsinphilanthropy.org/resource/resmgr/china_conference/liwei_wang_chinese.pdf)

foundation requires a large amount of capital and the procedures are complicated. As a result, the companies and individuals are not strongly motivated by tax savings to participate in charitable giving activities.

Generally speaking, the social and economic environment in China generates an immature market for the development of social enterprises, charities and impact investing. While on the other hand, huge social problems are pressing and the society is in dire need to create innovative solutions.

## 2.2 The Scope and Characteristics of Impact Investing in China

The concept of impact investing in China was learned from the Western countries but evolved in different ways. The definition is much narrower: it only refers to early stage equity or debt investments to private social enterprises to generate positive social impact as well as financial return. Investments in public stocks or debts are not considered as impact investing. Chinese social investors believe that the purpose of trading stocks is to gain profit rather than to provide direct support for the companies' development in generating social impacts as stock trading does not provide operational supports for public companies to scale its impact. On the other hand, early stage companies are in need of capital support and have a potential to scale up and deliver social impacts, and therefore this is where impact investing should occur.

Impact investing has been developing fast since 2012 when China hosted the first Social Investment Forum. Because of China's unique economic and social

conditions and less matured financial market, impact investing in China has unique features.

### **1) Mostly focused on early-stage equity investments**

In China, impact investing mainly invests in early-stage social enterprises. Although there is no official data, this phenomenon is confirmed by Chinese impact investor Mr. Xuedong Wang and social responsibility consulting professional Mr. Raymond Zhang, and can be observed in the report *2014 Social Impact Investment in China*. Globally, on the other hand, only 14% AUM was invested in early stage companies<sup>18</sup>.

Several reasons can explain the fact that early-stage impact investing is less prevalent globally. First of all, investments in early-stage companies bear higher operational risks. As the target company is in an early stage, the market and the product have not been proven. Even if the product can successfully solve social problems, low profit margin, inefficient business operation and competition from existing competitors may cause failure. Statistics show that around 90% of startups end up with failure<sup>19</sup>, thus investing in early-stage companies is riskier than investing in later stage companies.

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<sup>18</sup> GIIN. (2016). *Annual Impact Investor Survey*.

<sup>19</sup> Neil Pate. (2015, 1). *Of Startups Fail: Here's What You Need To Know About The 10%*. <https://www.forbes.com/sites/neilpatel/2015/01/16/90-of-startups-will-fail-heres-what-you-need-to-know-about-the-10/#6351f6d56679> 90%

Second, the liquidity risk of investment is high. Early-stage investors usually exit the investment in five to ten years, while the period of some impact investments is even longer in order to achieve desired impacts<sup>20</sup>. Additionally, whether the invested company could continuously achieve expected social impacts is uncertain. Some companies shift their business model or operational strategy as they develop and may fail in achieving original social impact goals. Furthermore, the comparatively smaller deal size and higher cost of impact measurement can make this kind of investment less economically efficient.

Why does impact investing in China focuses on early-stage investment? This may be because the less developed financial market in China makes it more difficult for small enterprises to raise money, thus early-stage investments are considered more impactful for social sectors. The financial market in China mainly benefits from larger companies: China's stock market has strict requirements on revenue and profit in order to be listed, and limited financial instruments are provided to unlisted smaller companies. As a result, listed companies are mostly mature and profitable, while small scale companies lack financing channels to support their growth. In China, 71% of social enterprises are very small and lack funding, while larger enterprises have an easier time raising money from donations or conventional investors. The limited financial support provided to small social enterprises and the lack of the knowledge to scale through leveraging capital make it difficult for social enterprises to continuously provide impactful services. In addition, the Chinese traditionally

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<sup>20</sup> The Impact. (2016). *Early-Stage Impact Investing - A Primer for Families*.

recognize societal benefit as related to contribution and donation, and people are critical about profit-driven activities that pass off as charitable. As a result, impact investing in China keeps the same spirit of philanthropy.

Another possible reason may be that the social environment of entrepreneurship encouraged the development of early-stage companies and early-stage investments. In order to develop the economy in the last decade, China established a Second Board and encourages fast growing companies to be listed and financed through exchanges. In 2015, the government encouraged the development of incubators, accelerators, VCs and PEs to support entrepreneurs. There were over 4,000 incubators in China in 2015, and it was estimated that 10,000 companies were newly established every day<sup>21</sup>. More social enterprises were also established and developed under this environment, but most are in early-stage and are small in scale.

## ***2) More willing to sacrifice financial returns***

In China, impact investing was developed from two paths: established by foreign foundations and transformed from non-profit foundations. According to impact investor Mr. Xuedong Wang, the impact investing fund he worked at cares more about social impact than financial returns, thus expecting lower than the market rate return, as long as the project is expected to be sustainable and scalable. This expectation is normal for impact investors in China. Another impact investor, Amanda Zheng from China Impact Ventures, did not reveal their specific

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<sup>21</sup> *The Dim Future of VC in China*. [http://www.sohu.com/a/128312948\\_490307](http://www.sohu.com/a/128312948_490307)

expectations on financial returns, but expressed that the expected financial returns are flexible because the investments are very early-stage thus difficult to predict.

While China's impact investors usually set the threshold of investment as sustainable rather than market level, most global impact investors (59%) are expecting risk-adjusted market returns<sup>22</sup>. This phenomenon in China might be because impact investors are less competitive and lack investment experience. VC, PE and angel investments has developed rapidly only in the last five years in China. Many people are attracted to these profitable industries, and it is very rare for experienced investors to change their focus to impact investing. China's local impact investors are usually employees from charitable foundations or new investors with less investment experience. Lack of experience and lack of money make it difficult for impact investors to compete with conventional investors for highly profitable transactions.

### ***3) Impact measurement is more qualitative rather than quantitative***

The impact measurement methods in China are also learned from the U.S. and Europe. IRIS and SROI are two well-known measurement guidelines. However, the execution of impact measurement faces problems from both the investor side and the investee side.

Chinese social enterprises usually lack skills and capacities to continuously measure social impacts. Similar to financial reporting, China developed later and slower than the U.S.: the U.S. issued the Accounting Standards in the 1970s to

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<sup>22</sup> GIIN. (2016). *Annual Impact Investor Survey*.

regulate financial reporting, while China did not have accounting standard until the 1990s. Even recently, financial information for private companies is still not well reported and regulated in China. Impact measurement requires private companies to collect additional information, and the process is time and resource consuming. Also, the selection of information is very subjective due to lack of standards. Furthermore, the information is not legally required, leading to investees lack of motivation.

Chinese foundations and impact investors do consider the nature of social impacts and estimated achievable impacts when they make investment decisions. The reporting of impact measurement to LPs or donors is mostly based on operational data or an estimation of achieved social impact rather than “additionality”. For example, the impact measurements of a special school usually only include how many students are served and how many jobs are created, while the comparison of the performance of their students with that of similar students in regular schools is not continuously tracked.

#### ***4) Small scale in fund size and deal size***

In China, impact investing funds have a smaller fund size and invest in smaller-size deals as compared to global impact investing funds. According to the *Impact Investing Index & Benchmark Statistics* (Cambridge Associations, 2015), most equity impact investing funds have a fund size of over USD 10 million and 20% with fund size over USD 200 million. The average deal size for impact investing through private



equity investments is around \$2.3 million<sup>23</sup>. In China, the fund size is mostly between USD 0.3 million and USD 20 million. Given the small fund sizes and the early stage of investment, estimated average deal size is below USD 0.5 million. Although the estimate may not be accurate, the difference between China and the US is large enough to show its small scale<sup>24</sup>.

The below table is a comparison between the major features of impact investing in China and the U.S.. There may be some other differences, including exit considerations, investment industries, and limited partners (LP) compositions, and so on.

**Table 2 Differences Between Impact Investing in China and the U.S.**

	<b>China</b>	<b>US</b>
<b>Scope</b>	Equity and debt investments mainly in early stage private companies	Investments through all asset classes mainly in late-stage companies
<b>Expectation of financial returns</b>	Usually lower than the market return, usually 5%-6%	More than half of the investors target the market return rate
<b>Impact measurement</b>	Mainly quantitative considerations lack of continuous standardized impact measurements	Several standard matrixes are developed to measure social impact
<b>Fund size and deal size</b>	Smaller in both fund size and deal size	Comparatively larger in fund size and deal size

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<sup>23</sup> GIIN. (2016). *Impact Investing Trends, Evidence of a Growing Industry*.

<sup>24</sup> Social Enterprise Research Center. (2013). *China Social Enterprise and Impact Investment Report*. The data excluded Lanshan Social Investment Fund, which is an asset management company investing in other asset classes.

## 2.3 Impact Investing Ecosystem

The impact investing ecosystem mainly includes capital providers, investment intermediaries, supporting service providers, and investment targets (impact creators). The ecosystem in China is not as complete as that in developed markets.

### ***Capital providers***

In China, impact investing capital providers are mainly private companies, foundations, high-net-wealth individuals, and family offices. Several foreign funds are active players in impact investing in China, e.g. LGT Foundation and Avantage Ventures. Financial institutions rarely participate in impact investing in China. Some state-owned financial institutions play an important role in providing financial support to infrastructure construction in rural areas of China, but the investments are not considered impact investing, rather responsibility investment. Globally, on the other hand, pension funds, insurance companies, banks and diversified financial institutions (DFI) contribute around 58% of the impact investment assets managed by fund managers, who manage the vast majority of impact investment assets<sup>25</sup>.

### ***Investment intermediaries***

In China, impact investment assets are mainly invested through impact investing funds, which are managed by fund managers. Globally, impact investment intermediaries also include banks, DFIs and other organizations, which in total manage around 35% of impact investment assets<sup>26</sup>. For example, JP Morgan invests

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<sup>25</sup> GIIN. (2016). *Annual Impact Investor Survey*.

<sup>26</sup> GIIN. (2016). *Annual Impact Investor Survey*.

its own capital through a Social Finance team. Some financial institutions also issue impact investing bonds.

### ***Supporting service providers***

Globally, there are several impact investing platforms and consulting firms supporting the fast development of impact investing. The supporting service providers include: 1) Global network and knowledge sharing platforms. These organizations play an important role in sharing industry knowledge and creating industry standards. For example, GIIN created a global network, shares global industry knowledge, and proposes the standard impact measurement methods IRIS. ImpactBase is an online knowledge and information database. Also, organizations like B Lab and GIIRS provide certification and ratings to impact investors; 2) Consulting companies and advisers like D. Capital Partners, and Cambridge Associates provide investment and strategic advisory to impact investors; and 3) Education institutions. Several universities including MIT, Harvard and Wharton have impact investing related classes as well as student organizations to provide impact investing knowledge and training. Wharton Social Impact Initiative not only organizes an MBA Impact Investing Network & Training (MIINT) every year but also conducts several impact investing studies and issues reports.

China also has supporting service providers to social enterprises and non-profit organizations, but their services are not focused on impact investing. The concept of impact investing is new, thus most organizations are still in a learning process. In China, the most influential platforms are China Alliance of Social Value Investment (CASVI) and Social Enterprise Research Center (SERC). CASVI is an investment

platform founded in 2014 by fifty foundations and institutions to support the innovation of social enterprises. SERC is a think-tank providing research, consulting and training for social enterprises. These platforms provide services not only for impact investing but also for broader social responsibility activities. Also, published reports related to impact investing are very limited, and there are no surveys or databases providing information about major impact investments or funds.

Consulting organizations for social responsibility mainly include Venture Avenue and Syntao. Venture Avenue provides evaluation and investment consulting to a number of NGOs, social enterprises, foundations and social investors. It also participates in venture philanthropy investments and has established a Social Innovation Hub with top universities. Syntao mainly provides consulting and training services of corporate social responsibility, green finance and social responsibility investments. In recent years, impact investing service providers has been gradually participating in impact investing activities, like Venture Avenue.

Several educational institutions in China, including Tsinghua University, Peking University and Beijing Normal University, opened social responsibility related classes and established research projects and institutions. However, most other schools lack such education and there are very few studies focused on impact investing.

### ***Investment targets (impact creators)***

Investment targets are mainly social enterprises, and sometimes infrastructure construction projects, which are the creators of social impacts. Globally, 60% of impact investment assets are invested in emerging markets and 51% are in financial

service (including microfinance) and energy sectors<sup>27</sup>. The investments in emerging markets were mainly in Latin America, Africa and India, and very few in China. The reason may be due to China's fast development and its unique language and political environments.

In China, the investments in financial services are comprised of a small portion of impact investing, and this phenomenon may be because the government strictly controls and regulates the financial system. Private companies need approval to operate microfinance or other financial activities. The approval procedures are complicated and requires a large amount of capital (around USD 71,000 minimum registered capital is required for LLC and USD 140,000 for C Corp), especially for foreign investors. In this case, impact investments in China are mainly in other sectors, such as education and energy.

## 2.4 Representative Companies and Investment Cases

Currently, there are a few impact investors and almost no exit investments in China. The *China Social Enterprise and Impact Investment Report* (Social Enterprise Research Center, 2013) disclosed below major impact investors in China:

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<sup>27</sup> GIIN. (2016). *Impact Investing Trends, Evidence of a Growing Industry*.

**Table 3 Major Social Impact Investment Organizations in China at a Glance**

<b>Year Established</b>	<b>Founding Institutions</b>	<b>Number of Investments (in China)</b>	<b>Total Investment Amount</b>
2012	Schoenfeld Foundation	2	Unknown
2012	World Resources Institute	4	Unknown
2008	LGT Foundation	2	Approximately \$300,000
2008	SA Capital	2	Less than \$500,000
2012	Avantage Ventures	3	Expected to be approximately \$20 million
2011	Private Equity	7	160 million RMB
2008	Fuping Development Institute	5	Unknown
2009	SOW Asia Foundation	1	500,000 RMB
2012	Xinhu Group, Venture Avenue	2	Unknown
2007	Shanghai Narada Group Co.Ltd.	Unknown	Unknown
2008	Entrepreneurs from Mainland, China, Taiwan, and Hong Kong	Unknown	Unknown
2002	Tsing Capital	>30	Unknown

Sources: Social Enterprise Research Center. (2013). *China Social Enterprise and Impact Investment Report*.

Among the list, there are only twelve investors, and the information for investments and funds was incomplete. Some investors are questionable as to whether they can be recognized as impact investors. For example, Tsing Capital is considered an impact investor in several reports because it invests in new energy and sustainable agriculture companies. However, it is considered a traditional venture capital or socially responsible investor rather than an impact investor by some other Chinese impact investors, because it does not actively measure social impact and it is not mission driven. Also, some impact investors on the list are no

longer active in China. For example, the website of China Impact Fund (www.cifund.cn) could not be loaded anymore; Avantage Ventures did not raise a new fund and has no full-time employees after it invested the fund's capital.

In order to better understand the different investment strategies and status of China's major impact investors, this paper analyzed their investment portfolios and strategies based on public information and interviews.

**Table 4 Brief Summary of Major Impact Investors in China**

<b>Organization</b>	<b>Investment Strategy</b>	<b>Investment Profile</b>	<b>Note</b>
<b>Transist</b>	Operates an incubator, provides consulting services, and invests up to \$0.5 million loan or equity investments to social enterprises.	Invested in nine environmental and healthcare companies.	N.A.
<b>China Impact Fund*</b>	China's first impact fund that provides financing to small and medium-sized social enterprises in the environmental industry.	N.A.	No longer active in China. Website www.cifund.cn cannot be loaded anymore. It is said that the fund shifted its business to clean energy social responsibility investments.
<b>LGT Venture Philanthropy and LGT Impact</b>	LGT Venture Philanthropy provides capital and strategic advices to support early-stage social enterprises in agriculture, energy, education, and other sectors. LGT Impact is a global PE impact investor.	Granted one company that maps and improves environmental pollution in China; In 2016 it invested in an e-commerce platform to improve the income of stay-at-home moms.	LGT is a globally active impact investor.
<b>SA Capital</b>	Triple-bottom line investing.	Five investments in education, labor employment and	N.A.

		financing industries.	
<b>Avantage Ventures Impact Fund*</b>	Early-stage equity investment in healthcare, rural development, employment, and clean technology sectors.	3-4 investments, including a special education institution.	Currently not active anymore.
<b>Lanshan Social Investment Fund***</b>	Fund I invests through equity, debt or convertible notes in growing social enterprises. Deal size is larger than \$0.15 million; Fund II invests in late-stage companies through stock market, convertible notes, trusts and bonds. Evaluate the social impact by Quality Of Life index (QOL).	Four early-stage investments in education and sustainable livelihood. Three late-stage investments in environment and agriculture industries.	Lanshan was focused on social impact investment, but realized that there are very few investable target companies. Currently, the main business of Lanshan is traditional investments including M&A and stock index investments.
<b>Beijing Leping Social Entrepreneur Foundation</b>	Support or establish social enterprises in micro-financing, education, and agriculture sectors.	Invested in two micro-financing companies. Established and invested in an early education company and an agriculture social enterprise. Venture philanthropy invested \$0.2 million in four projects.	It is transferred from philanthropy to impact investing.
<b>SOW Asia Foundation</b>	Venture philanthropy through debt or equity investments. It also operates an incubator.	2 projects in Hong Kong and 1 in mainland China: a waste recycle company, a eco-friendly construction material online platform, and a	The bespoke garment business may not as impactful as other investments because it has small scale of business and serves the high-end customers. The fund seems to gradually expand its investment scope.



		bespoke garment manufacturer that provides training and career opportunities to tailors.	
<b>Xinhu-Yu Fund</b>	Venture philanthropy investments between \$70,000 to \$700,000 in debt or equity.	Five investments in education and labor employment industries.	Established by the social enterprise and charity consulting company Venture Avenue. Expects low financial returns.
<b>Narada Foundation*</b>	N.A.	N.A.	Non-profit organization supports education and charity for catastrophe, and provides consulting services for social enterprises. The purpose of investment is to support the sustainable development of social enterprises with low financial expectations.
<b>YouCheng Foundation*</b>	N.A.	N.A.	Non-profit organization. Focus on social impact creation. It cooperates with several companies to invest in other impactful foundations and experiments innovative research and investments. It established an asset management company to generate greater impact through capital.
<b>Tsing Capital***</b>	Venture investments focused on clean energy. Measures social responsibility of investees regarding job creation, salary and taxes.	Over 30 investments in clean energy sector.	It is usually considered a SRI investor rather than impact investor.

*Note: The information is based on public information (including company websites) as well as interviews; \* represents funds that are no long active; \*\* represents funds with philanthropy nature; \*\*\* represents funds mainly conduct SRI or traditional investment.*

Through above information, we can see that impact investors and successful investment cases are very limited in China. Foreign organizations and Hong Kong institutions funded several impact investors including LGT Impact, SA Capital, and SOW Asia Foundation, and played an important role in driving the development. Other impact investing funds are mainly transitioned from charity foundations and social responsibility consulting firms, targeting early-stage companies, and expecting lower financial returns. This fact reflects that China has few late-stage social enterprises suitable for investment, thus investors tend to encourage innovation and support early-stage companies.

Although Avantage Ventures is no longer active in impact investing anymore, it is representative in its investment portfolio. According to Mr. Xuedong Wang, former partner of Avantage Ventures Impact Fund (Avantage), the firm valued more about the sustainability and social impacts of the invested firms as compared to high financial returns. Avantage invested in LangLang Learning Potential Development Center (LangLang), which develops software to identify children with reading barriers and provides training support to help them overcome this problem. LangLang was an early investment, however the investment is still not exited after five years. Avantage did not raise a new fund after they invested their capital in China. Currently, there is no full-time employees in the fund.

The fact that the China Impact Fund and Avantage Ventures are no longer active and that Lanshan Social Investment Fund and SOW Asia Foundation focused more in conventional investments with less social impact also shows the difficulties in continuously finding impact investment opportunities. The ambiguous definitions of

SRI and impact investing lead to different recognitions of impact investing and SRI. Tsing Capital is a representative SRI but is considered as an impact investor in several reports. Another fund, the Small Enterprise Assistance Fund (SEAF) Sichuan SME Investment Fund (SSIF) was considered as an impact investor and analyzed in the *Impact Investing 2.0 Case Study* (Case Foundation, 2014). SSIF invests in small and medium-sized companies primarily in the food and manufacturing industry pursuing a market return, and considered to generate impacts in creating jobs for low skilled workers. However, the fund is not considered an impact investor by other impact investors in China because the impacts are not considered significant enough. We can see the difference in scope of social impact and impact investing really differentiate between China and the rest of the world. On the other hand, there is a potential to gradually merge the concept of impact investing with conventional investment and other asset classes in China.

When some impact investing funds are gradually closed down, there are some non-profit foundations transferring and experimenting with a new model of pursuing both financial return and social impact, like Youcheng Foundation. In addition, there are several newly established impact investors like China Impact Ventures, which was established in 2014 and operates an impact investing incubator and also provides mentor guidance and seed funding to companies solving environmental and energy social challenges. China Impact Ventures stated that the prerequisite for their investment is the social impact. It is difficult to require a market return due to the early stage of investments, but they prefer to solve social problems with innovative solutions and high technology, which has profitability potential. One of its

portfolio companies is Equota, a high-tech company founded by MIT alumni that uses big data to save energy and is growing quickly.

In general, impact investing in China is still in its early stages. Impact investors and investment cases are all very limited, and related reports and quantitative analysis are even less. Impact investments are usually seed or early stage equity investments aiming to achieve larger social impact instead of competitive financial returns. There is a trend that foundations experiment in investments besides pure donation, and impact investors expand investments to SRI or conventional investments.

## 2.5 Other Activities in China Related to Social Responsibilities

Although impact investing is not well known by the public, there are other types of investments generating social impact but are not considered social impact investing in China.

### ***1) The government leads financial institutions to support impactful companies***

Green finance is an important social responsible investment approach in China. It refers to the financial support provided by financial institutions to the projects or organizations in environmental protection, clean energy, traffic and architecture sectors aimed at supporting the improvement of the environment, climate change and energy consumption efficiency<sup>28</sup>. In 2016, China's government issued the *Guidance of Constructing Green Finance System* to regulate and encourage the

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<sup>28</sup> China Daily. (2016, 9). *China is Gradually Forming the System of Green Finance*. Retrieved from [http://www.gov.cn/zhengce/2016-09/02/content\\_5104583.htm](http://www.gov.cn/zhengce/2016-09/02/content_5104583.htm)

development of green finance. Although green finance is not within the scope of impact investing in China, it needs more specific standards about impact measurements. This concept has raised the awareness of the importance to solving environmental social problems through financial instruments.

The development of green finance is driven by the Chinese government. The government also drives the development of rural areas and generates social impacts by providing loans to infrastructure construction and poverty alleviation projects through three policy banks by providing financial supports. For example, the Agricultural Development Bank of China is the policy bank that mainly provides loans to agricultural companies in rural China.

## ***2) Foundations and companies actively participate in CSR and charitable donations***

Companies generate social impact through corporate social responsibility (CSR) investments. CSR investments in China also aim to establish brand reputation, indirectly support marketing and sales, and build up customer relationships. Thus, sometimes companies consider CSR as an impact investment<sup>29</sup>. Cargill, one of the largest food, agriculture and industrial service providers in the world, is active in CSR investments in China. One of its CSR investments is to provide voluntary animal nutrition training to cow herders to help improve the quality of cow milk. Through the CSR investment, Cargill supported the development of rural agriculture, and at the same time, improved the quality of milk that is supplied to Danone, one of the largest food and beverage groups in China and also Cargill's major customer. This

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<sup>29</sup> Interview with Ms. Wendy Wen, CSR department of Cargill China

investment in return, provided Cargill a better customer relationship and more business opportunities with Danone.

The charitable foundations support the development of social enterprises from donations, and sometimes they cooperate with private companies to generate larger social impact. For example, the Gates Foundation is cooperating with the New Hope Group to provide training and chicken feed to African farmers to improve local lives. The Gates Foundation will provide part of the funding, and the New Hope Group, a large feedstuff manufacturer in China, will provide feed and chicken raise training. As a return, the New Hope Group could obtain the opportunity to enter the African market and cultivate potential customers. Also, the Gates Foundation invested and assisted the Chengdu Institute of Biological Products to research a low cost meningitis vaccine and to obtain the production approval from the World Health Organization (WHO). The vaccine will be sold in Africa to reduce meningitis.

### ***3) Incubators and pitch competitions encourage the development of innovation of social enterprises***

A number of incubators and accelerators were established to support innovation and entrepreneurship for social enterprises. For example, Transist is an incubator that provides guidance and financial support to innovative social ideas. Educational institutions also participate in entrepreneurial innovations. For example, Tsinghua University established an innovation accelerator to support student entrepreneurs. In 2015, Tsinghua X-lab cooperated with the Social Innovation Hub to encourage students to solve social problems through business knowledge.



## Chapter 3: Future Barriers and Opportunities

Impact investing has been gradually recognized and accepted as a socially beneficial investment approach; however, there are still concerns about its future development. GIIN analyzed 59,000+ English narratives in the U.S. and U.K. regarding opinions towards impact investing from October 2014 to October 2015. Seventy percent of the narratives showed positive attitudes and a belief that impact investing is a promising approach towards attracting private resources for solving social problems with innovative solutions; 11% held the neutral view that tax and investment vehicles related to regulations should be applied for lowering barriers and helping motivate investors to pro-actively pursue positive social impact; 18% were concerned that the lack of impact measurement standards and the conflicts between financial return and social impact may not effectively lead to solving social challenges<sup>30</sup>. This chapter will discuss the problems and suggestions about the development of impact investing, especially in China.

### 3.1 Problems Facing Impact Investing in China

The development of impact investing faces several difficulties in China:

#### ***1) How to define impact investing in order to be culturally accepted***

Globally, impact investing has a broad definition and covers all asset classes. The investors are so diversified, including many mission-driven investors like Root Capital, which provides training and loans to rural farmers in frontier markets with

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<sup>30</sup> GIIN. (2016). *Narrative Analytics™ on Impact Investing*.



negative financial return, market-return investors like Bain Capital Double Impact, which invests in growing companies in addressable markets with market return, and public investors like Wellington Global Impact Fund, which invests in ESG<sup>31</sup> stocks. Due to the breadth of the definition, and no lack of an authority to certify impact investing funds, some organizations are taking advantage of the concept to attract low-cost capital. There are also cases when some impact investors do not recognize another as an impact investor. Apparently, the broad definition makes it easier to be accepted and adopted by mainstream investors, but whether the concept will be abused or accepted by the public is uncertain.

In China, most foundations and impact investors are adopting a narrower definition of impact investing; they are reluctant to accept a broader definition. Profiting in stocks and investing in late-stage companies with conventional investors targeting for market return does not generate actual impact, considering the “additionality” of capital. The narrow definition better suits China’s culture and social recognition, and it protects impact investing as an investment approach pursuing positive social impacts.

On the other hand, although China applies several terms like green finance, CSR, SRI, trust philanthropy, venture philanthropy, and so on, the narrow definition of impact investing makes it less familiar to the public and limits its development into a mainstream investment approach. In addition, impact investing is translated into

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<sup>31</sup> Refers to environmental, social and governance, the three aspects to measure the impact and sustainability of an investment.

different terms in Chinese, sometimes as “影响力投资” (impact investing) and sometimes as “社会价值投资” (social value investment), causing confusion as to its true meaning and making impact investing less widely recognized.

## ***2) The implementation of impact measurement***

The difficulty of measuring social impact is not only faced by China but also globally. Although IRIS, GIIRS and SROI provide tools to measure social impact, impact measurement can be costly and different for companies in different industries. Impact measurement is important in continuously evaluating and driving social enterprises to generate positive social impact. Therefore, it is proposed that there should be an efficient and standardized impact measurement policy to help guide the development of impact investing.

In 2017, at the Harvard Social Enterprise Conference, employees from social enterprises were concerned with the development of impact measurements and impact investing guidance (like Generally Accepted Accounting Principles for accounting), with expectation of tax incentives for encouraging attraction of a broader range of private capital. However, some people working in the impact investing industry are concerned that certain standards may shape impact investing as a unique investment approach different from mainstream investments, with a risk of discouraging the investors from adopting that approach<sup>32</sup>.

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<sup>32</sup> Interview with Ms. Liesbet Peeters, managing partner of D. Capital Partners, an impact investing consulting firm

In China, there seems to be an even longer time period in which to implement impact measurements. This phenomenon can be caused by a lack of motivation, lack of budget or resources, or a lack of understanding about the importance of the matter. If we consider spreading the awareness of social impact, continuous impact measurement may be undesirable because certain requirements might stop investors from taking actions. However, in measuring social impact, comparing and optimizing the matrix is important for evaluating the investment return, convincing potential investors, and motivating social enterprises.

### ***3) Lack of investment motivations***

According to GIIN survey, lack of investment capital is one of the biggest problems encountered by investors, which indicates lack of investment motivations. In China, the problem seems to be even more severe because there is a lack of participants and limited fund sizes. The concept of impact investing is to achieve both social impact and financial returns, aiming to encourage participation of private capital. However, investors may be skeptical about market return rates when pursuing positive social impact, or they may be reluctant to compromise financial returns for positive social impact because there are no tax benefits or other incentives.

In the U.K., special tax benefits are provided to impact investors, but other countries do not provide them any special tax preferences. There are voices advocating that tax incentives should be provided to impact investing, especially to those giving up financial return for positive social impact. However, at the current

stage, due to the imperfection of standards and regulations, such a tax policy is very difficult to execute.

#### ***4) Lack of resources and knowledge centers***

China does not have a platform like GIIN to collect and evaluate impact investors' information. Although SERC and CASVI provide a platform for institutions and individuals caring about social enterprises, there is limited research, case analysis, or survey data about impact investing in China.

Due to the lack of platforms to collect information for research and study purposes, current knowledge of impact investing in China is mostly brought from overseas. The active players in China mostly have overseas backgrounds, but the number of participants is too small to cause any influence. In universities, there are likewise few studies in this industry.

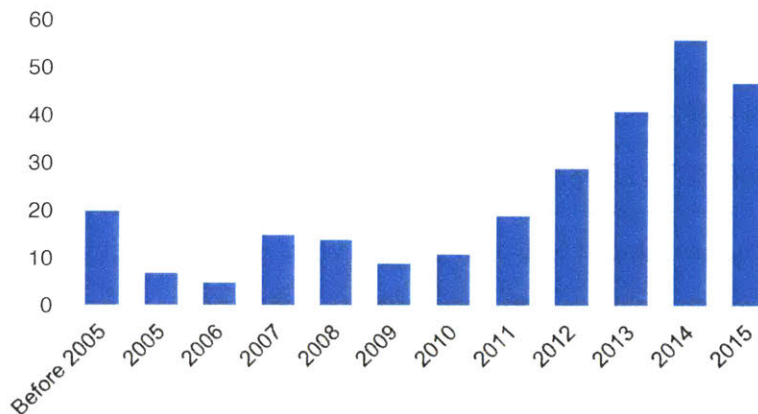
Resources that are lacking also include professionals in the industry who have a broad knowledge of finance and social impact and understand business to a great extent. Although the younger generation is coming to care more about social responsibilities, the impact investing industry cannot attract young talent if it fails to provide enough training.

#### ***5) Limited social enterprises as investment targets***

Social enterprises are in an early stage and lag behind in innovation; thus, they are not sustainable and suitable for investment. In China, around 54% of social enterprises have been established since 2012, and 71% of them are on a small scale

with revenue less than USD 70,000<sup>33</sup>. Traditional social enterprises are funded by charitable foundations, but they are not self-sustaining due to lack of innovation or business operation experience.

**Figure 5 The Establishment of Social Enterprises by Year**



Notes: the total number of social enterprises by 2015 was 273.

Sources: DBS. (2017, 2). Greater China Social Enterprise Survey.

In this case, impact investing is a selective process that utilizes the capital to support the development of those companies with social impact and the ability to sustain themselves. However, impact investors in China have indicated that it is not easy to find investment targets that meet these requirements. What the social enterprises need is not limited to capital, but also includes advices, training and operational assistance. Root Capital is an investment source that not only provides funding for farmers, but also financial training.

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<sup>33</sup> Jiefang Daily. (2015, 10). *The Development of Venture Philanthropy in the Entrepreneurship Era*. Retrieved from [http://news.xinhuanet.com/local/2015-10/02/c\\_128286316.htm](http://news.xinhuanet.com/local/2015-10/02/c_128286316.htm)

## ***6) Exit and continuous value creation***

Impact investing usually requires a longer period of investment in comparison to conventional investing. However, longer periods of investment involves more uncertainty as to the investment returns; yet shorter time horizons may jeopardize the generation of continuous impact.

The long investment period contributes to the limited exit channels or inactive capital markets for social enterprises. This problem is more difficult in China, where impact investing has developed only during recent years, with limited investors, who are mostly investing in early-stage companies with no known exit cases. Usual exit strategies for impact investments include selling to strategic buyers or financial buyers, IPOs, and management buyouts. However, in China, none of the exit strategies is easy: there are few late-stage impact investors who invests in the next round, the investments below market financial return rates cannot attract conventional investors, and the main stock exchanges have high financial and profitability requirements and thus social enterprises are rarely listed. The National Equities Exchange Quotations (NEEQ) in China provides a trading platform for small businesses. However, it is costly to be listed, and the equity trading on the platform is not very active.

There are a few stock exchanges for social enterprises globally, including the Social Stock Exchange in London (UK SSE), established in 2013, and the Impact Exchange Social Stock Exchange, dedicated to connecting impact enterprises with

capital that reflects values in Asia and Africa<sup>34</sup>. These exchanges face the challenge of providing active trading (the stock exchanges are not active, with only 12 companies in London SSE) and providing fair evaluation.

### 3.2 Opportunities and Suggestions

Although impact investing is not well known in China at the current stage, there are several trends showing its growth potential. First of all, the increasing number of newly established social enterprises and charitable grants shows that more and more people have started to care about social contributions. This trend provides more opportunities for impact investing to be accepted and adopted by the general public. Second, the increasing number of students going to study abroad in recent years will bring back the concept of social responsibility. The number of Chinese students studying abroad in 2015 reached 0.5 million, which is more than double the number of five years ago. At the same time, the number of students going back to China is also increasing and reached 0.4 million in 2015. As more people studying abroad are returning to China, they bring back the concept related to social responsibility, which can influence the entire population in China. Furthermore, the financial industry in China is developing fast, including green finance, which is encouraged by the government and is considered impact investing under the broader definition. We can expect similar concepts and guidance about social responsibility in other asset classes including private equity and venture capital.

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<sup>34</sup> Information refers to <https://iixglobal.com/impact-exchange/>

To accelerate the development of impact investing in China, the following suggestions seem advisable:

1) Establish a nationwide impact investing network among impact investors, research institutions, and authority and establish industry norms, evaluation or certification systems, and knowledge centers. Increase the transparency of the industry and create a sharing and supporting network. Such a platform can help investors learn from each other about investment cases and investment strategies, understand the difficulties of the industry and drive the changes together. At the same time, the platform will raise more awareness and become a channel to bridge all parties in the ecosystem.

2) The Chinese government should drive the development by providing supportive policies. First, the government should encourage the capital support for sectors that generate strong social impacts, such as education and minimizing poverty. The government should also provide related guidelines, subsidies, and incentives to support the development of social enterprises and impact investors. Second, the government can encourage companies, both state-owned and private enterprises, to include social impact as one of their performance metrics and support social enterprises through government purchases. Finally, the government can provide an open and supportive environment for social enterprise by lowering the capital registration requirement for social enterprises, foundations, and social enterprise service providers.

3) Improve cooperation and collaboration among foundations, investors, industry leaders, and the government to provide capital support for social



enterprises. Capital from government and foundations can subsidize and attract industry leaders and investors to provide more capital, especially by applying their expertise to solving key social problems. Industry leaders and financial investors are encouraged not only to supply capital, but also to provide industry and business guidance to social enterprises. As a result, social enterprises can obtain more support to achieve sustainability.

4) Increase awareness of social responsibility and education related to impact investing. Schools play an important role in shaping people's social values. Thus such education is needed not only in specific programs related to sociology or public administration, but also more broadly. For example, at MIT Sloan, Impact Investing is not only an elective course, but also a topic frequently discussed in several other finance related courses, such as Entrepreneurial Finance and Venture Capital. Civic education should be considered a necessary part of all kinds of education, and at all levels.

There may be other ways to support the development of impact investing, such as establishing social enterprise stock exchanges, creating impact measurement standards, and so on. Among the different options, encouraging participation of all parties and creating a supportive ecosystem for social enterprises are more crucial. In this way, more people will become aware of the importance of social responsibility, and impact investing can become more mainstream.

## Chapter 4: Conclusions

Impact investing has become a fast growing sector in recent years. It provides an innovative approach where capital invested can achieve financial returns while also generating positive social impact. Although some social problems cannot be easily solved while achieving financial returns, impact investing still inspires investors to consider social sustainability and the long-term effects to drive changes with their investments. We expect a trend of more charitable foundations that will experiment with impact investing by evaluating the sustainability of social enterprises; more conventional investors will consider social responsibility beyond financial returns by measuring the impact of their investments.

China is learning from the Western countries about the impact investing concept and the practices, and impact investing in China is developing its own unique characteristics that fit the environment. Due to China's unique social and economic environment, the development of impact investing is encountering a lot of practical problems, and it takes time to improve the public awareness of social responsibility. Also, because of the late start in the development of impact investing in China, there have only been a few successful cases. Overall, impact investing in China is in an initial experimental stage and has not started to scale. However, the culture is in transition and there is a trend that foundations and the government is guiding more private capital to support sustainable social innovations. I believe that as China continues to open and learn from the Western countries, the development of impact investing in China will gradually develop towards international standards.

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