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Impact investing

Switzerland's pioneering role

Loans for Growth Fund: a successful public-private partnership for development

How does Switzerland stay ahead?

Switzerland's pioneering role

Impact investments have become an integral part of development cooperation. The fact that Switzerland is now a leader in impact investing also reflects the role of the State Secretariat for Economic Affairs. *Liliana de Sá Kirchknopf*

Abstract Impact investing makes an important contribution towards achieving the UN Sustainable Development Goals (SDGs). The beginnings date back to the 1990s, when what was then the Federal Office for Foreign Economic Affairs (BAWI) participated in the first impact investment funds. Switzerland has since become a global leader in impact investing. However, in order to achieve the SDGs by 2030, the sector must find its way out of its niche. The State Secretariat for Economic Affairs and its international partners are therefore mobilising private financiers for new impact investment funds to create jobs, infrastructure and services in developing countries.

Impact investing is in vogue: the Swiss government is participating in dialogues with stakeholders in Switzerland, the renowned daily newspaper *Neue Zürcher Zeitung* (NZZ) is organising an "Impact Finance Forum" at the end of September, and in November, the second edition of "Building Bridges" – a conference aimed at establishing a movement and driving investment to achieve the UN Sustainable Development Goals (SDGs) – will take place in Geneva. This is hardly surprising, given that Switzerland is a global leader in impact investing: according to the fund provider Symbiotics, one-third of all impact investments are managed in Switzerland. Impact investments are investments that aim to achieve a positive and measurable impact on the environment and society in addition to a financial return. In terms of achieving the UN's 17 SDGs by 2030, impact investments will play a key role. Currently, investors are primarily focussed on poverty reduction, economic growth, gender equality and climate change mitigation.

How it started

By focusing on impact, impact investing goes a step further than "sustainable finance", which generally incorporates environmental, social and governance (ESG) criteria into business or investment decisions. In terms of overall share, impact investing still ekes out a niche existence in Switzerland: only 1.3 per cent of all managed investments are impact investments (see figure). However, the sector is growing particularly fast; it tripled in 2020 compared to the previous year.

The beginnings of impact investing in Switzerland date back to the 1990s: In 1995, what was then the Federal Office for Foreign Economic Affairs (BAWI) – the predecessor to the State Secretariat for Economic Affairs (SECO) – was at the forefront of participating in the first commercially oriented micro-investment fund in Latin America. It did this together with bilateral, regional and multilateral institutions, as well as foundations (including the Fundes Foundation, which was founded by Swiss entrepreneur Stephan Schmidheiny). The Profund fund invested in 12 microfinance institutions that provided capital to nearly one million micro- and small enterprises. Over its 10-year lifespan, the USD 22 million fund generated a 7 per cent return.

This was proof that impact – in this case, poverty reduction through entrepreneurship – and return on investment go hand in hand. Profund laid the foundation for another investment, this time with purely Swiss players: In 2003, SECO paid USD 3 million in seed capital into the microfinance fund set up by Zurich-based asset manager Responsability in order to target developing countries. The private sector contributed another CHF 3 million. The public distribution approval marked the first time that an impact investing product was made available to a broad audience through retail. Four years later, the amount invested by SECO was repaid in full. The fund now manages over USD 1 billion and is invested in more than 90 countries. The leverage effect was therefore enormous.

Expansion with SIFEM

In the following years, SECO made further fund investments in developing and transitioning countries. To create more suitable structures for commercial impact investing, the portfolio was transferred to the federally owned corporation Swiss Investment Fund for Emerging Markets (SIFEM) in 2011. SIFEM AG – supervised by SECO with strategic targets set by the Federal Council – has since developed strongly: the portfolio is now close to USD 900 million.

Complementing SIFEM AG, which has a return target of at least 3 per cent, SECO continues to use selective start-up financing and loans in development cooperations. [1] For example, SECO finances the activities of investors or foundations that bear the risks to achieve results. In 2017, together with the Colombian government and the Inter-American Development Bank, SECO launched the first social impact bond in a developing country in record time. The focus is on integrating poorer segments of the population into the formal labour market, with SECO and the Colombian government paying only for results achieved. If the results are exceeded, investors will receive a bonus.

Platform established

With the development funds used for impact investing, SECO aims to create a demonstration effect and mobilise private investment in order to achieve the UN Sustainable Development Goals. Since the framework conditions are ultimately decisive, SECO is committed to this at both an overall and international level. Important fora include the Organisation for Economic Co-operation and Development (OECD), multilateral development banks, targeted initiatives such as the Climate Bonds Initiative, and donor networks such as the Aspen Network of Development Entrepreneurs. In Switzerland, SECO also provided start-up funding to the Swiss Sustainable Finance association in 2014. The association coordinates the industry's efforts in sustainable finance, with a working group – with SECO's participation – that specifically addresses impact investing in emerging and developing countries.[1]

1 For more information, refer to the article by Massimo Bloch, Diana Celotto and Safeya Zeitoun in this issue.

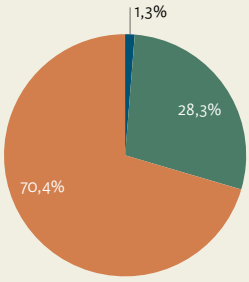
A vibrant ecosystem for impact investing now exists in Switzerland. Traditional financial institutions are also increasingly entering the fast-growing market, as demand for sustainable financial products increases among their clientele. For example, British investment giant Schroders acquired the Swiss impact specialist Blue Orchard two years ago.

More competition

While impact investing has established itself in microfinance and renewable energy is also becoming more commercially viable, the proof still needs to be better demonstrated in other sectors as well as in the poorest countries. In these areas, temporary public support may be warranted. Therefore, in 2017, for the first time in the history of development cooperation, SECO launched directly an open call for proposals called "SECO 17". The aim was to elicit the most appropriate funds to address the UN Sustainable Development Goals on decent work (SDG 8) and climate change mitigation (SDG 13). Rather than providing ad hoc support, the submission process was based on competition, which helped optimise cost-effectiveness. As a result, three funds received a total of CHF 4 million in non-repayable support from SECO. One of these innovative funds was the Meloy Fund, which focuses on investments in SMEs active in sustainable fisheries and coastal restoration in Indonesia and the Philippines.

Based on their experiences with "SECO 17", SECO intends to scale up the project submission process with the "Swiss Impact Investing Initiative". By the end of the year, innovative, promising, but still risky new initiatives will be selected for start-up financing support in a competitive process.

Sustainable investments in Switzerland (2019)



SWISS SUSTAINABLE FINANCE/DIE VOLKSWIRTSCHAFT

- Impact investing: CHF 50 billion.
- Other sustainable investments: CHF 1,103 billion.
- Other investments: CHF 2,747 billion.

At the end of 2019, the total volume of investments in Switzerland amounted to CHF 3.9 trillion.

Out of the niche

The private sector plays a central role in addressing development challenges, which is also reflected in Switzerland's international cooperation strategy for 2021 to 2024. Without capital, innovation and expertise from the private sector, we will not be able to achieve the UN's Sustainable Development Goals. The COVID-19 pandemic has dramatically exacerbated the situation, with millions of people at risk of falling back into poverty. In the rapidly growing field of impact investing, SECO sees its role in conducting pilot projects and providing seed funding with a focus on the UN Sustainable Development Goals (by 2030) and the Paris Climate Agreement.

To achieve the 17 SDGs, impact investing must grow out of its niche. Collaboration with institutional investors such as pension funds has a key role to play. Building on the strengths of its financial centre, Switzerland has the potential to continue to lead the way in impact investing. This is also the aim of the newly founded public-private platform finance.swiss, with which Switzerland aims to position itself internationally in the field of sustainable finance and fintech. To achieve this objective, Switzerland must also quickly progress in terms of digitalisation. This will offer new solutions in a wide range of areas, including impact measurement.

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Loans for Growth Fund: a successful public-private partnership for development

In 2016, together with two partners from the financial sector, SECO launched an impact fund as a public-private partnership for the first time. Thanks to the fund, 50 million US dollars were invested in emerging countries. *Massimo Bloch, Diana Celotto, Safeya Zeitoun*

Abstract The *Loans for Growth Fund* is a public-private partnership between the State Secretariat for Economic Affairs (Seco), the bank UBS and the Geneva-based fund promoter Symbiotics.. During its four years existence, the Fund linked private investors with small and medium enterprises (SMEs) in emerging markets thereby mobilizing private capital for economic development and growth. The partnership supported 3,700 SMEs that employ over 22,000 workers, 40% of which are women. SECO received full reimbursement of the first loss capital.

A Ghanaian small business owner unlocks her potential with a loan

In 2006, Auntie Esther, as she is known in her village in Ghana, started a small shop in a container. Two years later, as her business started growing, she bought the land where her container was located and built a small provision shop. At that point, the female entrepreneur faced a problem. She wanted to grow further but she could not fulfil her potential because of limited access to finance.

It was only in 2017, that she learnt about Advans Ghana, a mobile money service provider that enabled her to access a USD 2,000 loan. With this loan, she diversified and increased her stock of products. Clients now keep coming back and she even sells to other provision shops in the area. Today, she has five full-time employees and plans to start catering food and beverages for weddings.

Like Esther, many other entrepreneurs and SMEs in low- and middle-income countries are confronted with no or limited access to finance to promote their growth. In many regions, SMEs are too big to be eligible for microfinance institutions, but too small or too risky to enter the client pool of banks, leaving them underbanked. This is commonly referred to as the "missing middle". At the same time, entrepreneurs' lack of financial literacy adds to the challenge.

Limited access to finance needs a solution because SMEs are the backbone of the economy and the largest source of employment. Nine out of ten jobs in emerging markets are created by SMEs and decent jobs are the key way out of poverty. SMEs growth should not be "missed" by financing options.

With the right framework conditions for access to finance for SMEs in place combined with good enough financial literacy among entrepreneurs, the main providers of viable financing solutions are specialized SME financial institutions. Creditors are often investors from industrialized countries.

Mobilizing private capital

Specialized financial institutions are finding it increasingly difficult to meet the growing credit needs of SMEs. The coronavirus crisis has further exacerbated the problem. In this context, partnerships between state actors and private investors can play an important leverage effect. Many private investors are willing to put money into a sustainable project if they know it is in good hands.

The Loans for Growth Fund is a good example of a public-private partnership for economic development cooperation. Created in 2016 and limited to four years, this project is a joint venture between the State Secretariat for Economic Affairs (Seco), the major bank UBS and the Geneva-based fund manager Symbiotics.

The Fund has improved SMEs' access to finance and inclusion, job creation and entrepreneurship. It has provided loans to 42 financial institutions in 24 countries, including Peru, Georgia, Moldova and Ghana.

At beneficiary level, over 3,700 SMEs accessed credits. These businesses emply over 22,000 workers, of which more than 40% are women, and more than 90% are full-time employees with a stable job. The SMEs provide their employees with a fair wage in line with local economic conditions. The loans provided through the Fund also enabled many SMEs to invest in new assets for their businesses and expand their activities through new products and services. The Peruvian seed and quality grain company AGP Semillas and a Moldovan advertising agency (which financed better and more modern printing equipment) were among the beneficiaries of this funding.

A leverage of 1 to 10

The Fund linked private investors with SMEs by tackling the above average risk perception. The Fund used an innovative structured capital approach, whereby SECO, in partnership with UBS AG, provided a financial cushion for private investors.

The fund structure contained a first loss tranche of CHF 5 million split equally between SECO and UBS which was designed to absorb any investment losses of up to 10% of the total Fund›s value of CHF 50 million. This innovative feature allowed the Fund to mobilize private capital with a ratio of 1 to 10 and deliver much needed capital to SMEs-specialized banks in developing markets.

SECO entered this partnership to test the impact hypothesis and act as a catalyst to scale up the mobilization of private capital for development, in line with its mandate. The Agenda 2030 is explicitly clear on the need to mobilize private capital if we are to achieve the Sustainable Development Goals (SDGs) and public-private partnership are

one of the key approaches to do this. SECO's motivation was also based on the idea that if a big bank, such as UBS, can find a working solution to increase the share of their assets invested to generate impact, it can start to move the needle and accelerate impact investments.

A comprehensive impact reporting

The combined expertise and resources of the three Swiss players in the Loans for Growth Fund have made it possible to design a financial instrument capable of absorbing significant risks. Seco and UBS acted as catalysts for private capital. Seco also contributed its long experience in emerging markets and development effects, while UBS took care of fundraising. Symbiotics, meanwhile, brought its knowledge of impact measurement, credit assessment and asset management in emerging markets to bear.

Since the fund›s launch in 2016, Symbiotics has published a comprehensive effectiveness report each year enriched with a variety of metrics including business outcomes, employment inclusiveness, and workplace safety. By providing valuable information on impacts (intended and unintended) at the financial institution and SME level, these reports advance the debate on measuring the effectiveness of impact investments.

A positive financial performance despite the Covid-19 crisis

The first loss tranche is fully repaid to SECO and UBS and the fund delivered a positive and stable financial performance, with a positive final annualized return to the shareholders (the final outcome depending on the repayment of the outstanding) investments. Thanks to adequate diversification and low default rates on its investments, the Fund has generated steady positive returns for the investors, resulting in regular dividend distributions totaling USD 4.4 million. The ultimate return is probably still at the lower end of investors' expectation from a pure investment perspective but in a low interest rate environment is a valid alternative. Moreover, the development impact was for many an additional consideration in their investment decision.

The coronavirus crisis has affected the fund›s payment and repayment schedule. As a result, some loans were extended beyond September 2020 to increase the chances of recovery. Even robust SMEs experienced a decline in activity due to macroeconomic difficulties and containment measures. Some investments have therefore been extended, in collaboration with other international lenders, to help institutions facing liquidity problems. Amounts due are expected to be recovered by June 2021.

Going forward

The Loans for Growth Fund managed to mobilize CHF 50 million towards sustainable economic development, a very small fraction[1] of the USD 2,5 trillion needed to achieve the SDGs. Nonetheless, the partnership showed that de-risking structures are, at least partially, effective and that capital invested in SMEs does generate development impact and creates value.

Going forward, all three sponsors of the partnership have the intention to continue this journey. Symbiotics has several initiatives underway for future blended funds, where public money is used to de-risk private investments, as this set-up will continue to be crucial to mobilize enough capital. UBS has also actively embarked on the journey to mobilize private capital towards impact investing by making a public commitment to raise USD 5bn towards impact in five years – a goal that was achieved in 2021.

1 The financing gap is estimated $2.5 trillion per year, United Nations

Since 2016, SECO has further reinforced its engagement to catalyze the mobilization of private capital for development by shifting to a more systemic and competition-based approach. This approach was successfully started in 2017, with an international open call for proposals to support impact investment funds. SECO will continue down this road and scale up the mobilization of private capital for the SDGs via industry- and ecosystem-based interventions, and by strengthening partnerships with Swiss and international partners.

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How does Switzerland stay ahead?

Switzerland has a strong ecosystem for impact investing. To further grow and increase its impact, better collaboration among stakeholders is needed.

Miroslav Delaporte, Lukas Schneller, Patrick Elmer

Abstract **The consulting firm iGravity was commissioned by the State Secretariat for Economic Affairs (SECO) to examine the Swiss ecosystem for impact investing using a SWOT analysis: Strengths include its financial center and a strong culture for innovation. The fact that impact investing remains a niche compared to the market as a whole is a weakness. An opportunity is the attitude of Millennials, who place more value on measurable impact and sustainability. Finally, inconsistent practices and standards present some risks, for instance regarding "impact washing.".**

The private impact investing market is estimated to be worth $33 billion in assets worldwide – one-third of which is managed in Switzerland[1]. Accordingly, a diverse ecosystem of private and public actors has emerged in this country. Major microfinance asset managers based in Switzerland include BlueOrchard, ResponsAbility Investments and Symbiotics.

On behalf of the State Secretariat for Economic Affairs (Seco), the consulting firm iGravity conducted a project feasibility study to examine the Swiss impact investment ecosystem using a so-called SWOT analysis[2]. Impact investment comprises sustainable investments that combine returns with an environmental or social impact. An impact intend is key. The acronym SWOT stands for strengths, weaknesses, opportunities and threats. Individual aspects are discussed below.

The Swiss ecosystem includes asset managers, charitable foundations, pension funds, banks, insurance companies, academia, rating agencies and consulting firms (see figure). In addition, there are the associations Swiss Foundations, Swiss Association for Responsible Investments (SVVK – ASIR), Sustainable Finance Geneva (SFG), and the umbrella organization Swiss Sustainable Finance, which was founded in 2014. The ecosystem also includes various state actors. For example, the State Secretariat for International Finance (SIF) and the Financial Market Authority (Finma) are responsible for the regulatory framework. The federally owned Development Finance Institution (SIFEM) invests in funds that are intended to achieve an intended, measurable development impact in addition to a return. Furthermore, there are the economic development cooperation activities of SECO and the activities supported by the Swiss Agency for Development and Cooperation (SDC)[3].

The strengths

What are the strengths of the Swiss impact investing ecosystem? First, Switzerland has one of the largest financial centers in the world specializing in asset management. This provides a unique source of funding for impact investing. Second, Switzerland has a strong culture for innovation. For example, Switzerland repeatedly ranks first in the Global Innovation Index. Accordingly, the financial sector is also open to new approaches such as impact investing.

Third, Switzerland is home to important international organizations such as the UN and the country has a long-standing humanitarian tradition. This also includes a strong network of non-governmental organizations. The emergence of the microfinance industry benefited from this proximity. The expertise it generated is now increasingly in demand by the financial sector. Meanwhile, some universities have also introduced impact investing in their curricula and offer specific training courses.

The weaknesses

What are the weaknesses of the Swiss ecosystem? First, on needs to acknowledge the fact that impact investing remains a niche compared to the overall market. In general, institutional investors such as pension funds, which would be crucial for scaling, remain cautious and conservative. Further, many

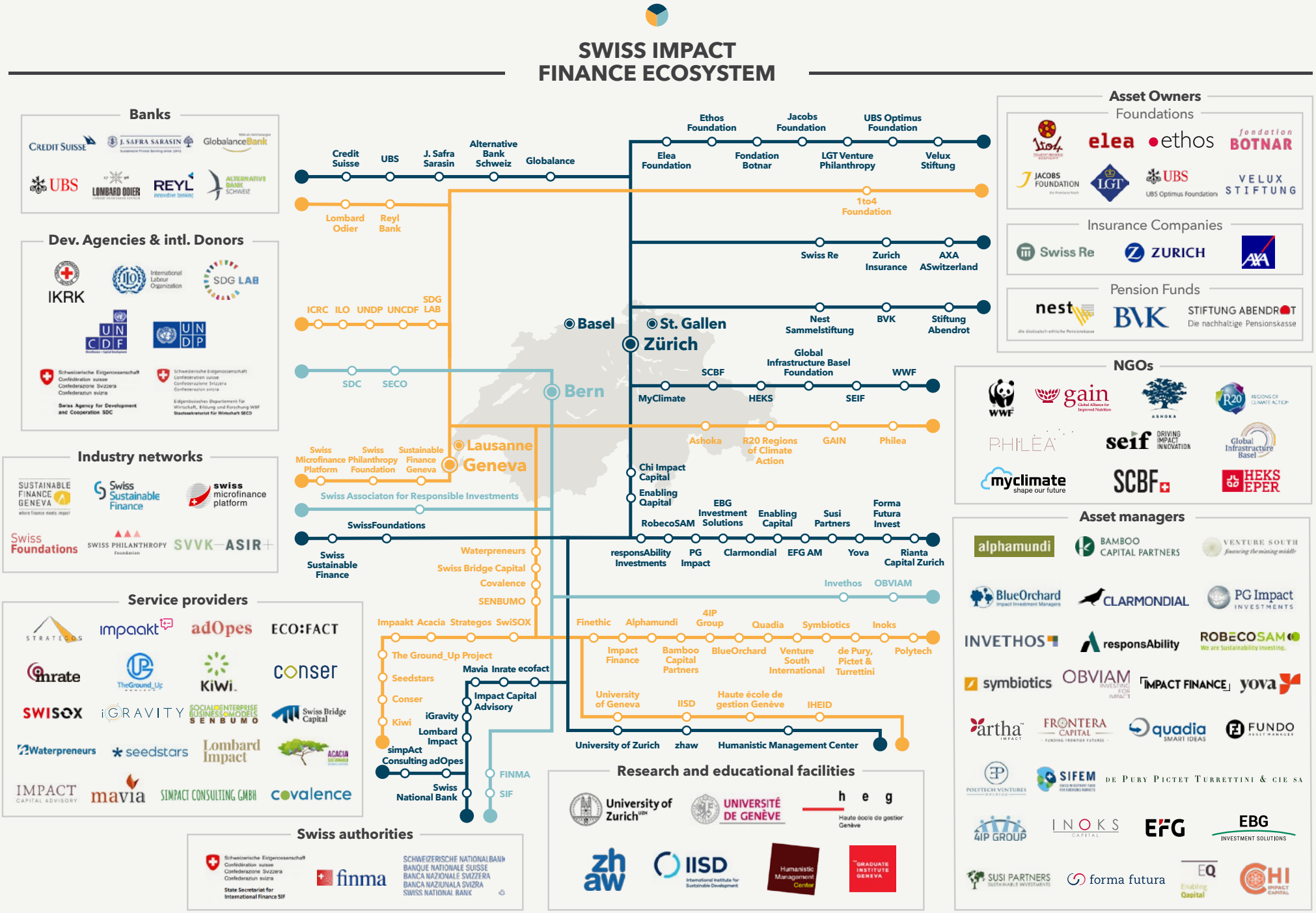
1 Symbiotics/Canopy (2020): Private Asset Impact Fund Report 2020

2 Internal feasibility study for a new project.

3 Cf. Article by Liliana de Sá Kirchknopf in this same edition of the Volkswirtschaft.

Microfinance funds support micro-enterprises in emerging and developing countries with loans. Fisherwoman in the Philippines.

SWISS IMPACT FINANCE ECOSYSTEM



iGRAVITY (2021)

impact asset managers are "trapped" in the microfinance world and players are highly fragmented. In this context, there is confusion about what even qualifies as "impact."

In addition, there are regulatory hurdles such as the stamp duty, taxation of products, and lack of access for retail investors and for foundations. Because of small transaction sizes – and the concomitant costly on-the-ground due diligence and monitoring – transaction costs for many impact investing funds are very high. Finally, impact investments have neither a secondary market nor a listing on the stock exchange, which makes "mainstreaming" and scaling difficult. Accordingly, the leverage of projects is modest.

Momentum thanks to millennials

At the same time – and here we move on to the opportunities – a fundamental shift is taking place in the mindset of investors. The next few years will see a large transfer of wealth to the generations of "millennials" born after 1980, who place more emphasis on sustainability. In addition, institutional investors are coming under increasing pressure from regulations and public opinion to commit to the UN Sustainable Development Goals.

The public and private sectors can work together profitably here. New technologies, such as blockchain and crowdfunding, have the potential to reduce transaction costs, increase transparency, and encourage more investment in the sector.

What are the risks? Some risk to the ecosystem comes from impact measurement. This is currently inconsistent. As a result, there is a risk of "impact washing," i.e., providing inaccurate or exaggerated reporting on results, which could trigger a breach of trust within the investment community. In particular, the different definitions of impact investing, the lack of internationally comparable data and underdeveloped methodologies make comparison and transparency difficult. Further, failure to achieve expected financial or impact goals can hamper the reputation of impact investing and threaten the growth of the industry.

Competition never sleeps

Other financial centers such as the Netherlands and Luxembourg are not sitting idle when it comes to impact investing: They are trying to gain market share with attractive framework conditions – for example, favorable regulatory and tax rules and a high number of investment fund experts. If Switzerland wants to maintain and expand its leadership role, it must continue to position itself and become more competitive.

In the survey conducted by iGravity, 88 percent of respondents said they would welcome more collaboration between the public and private sectors. They hope that public sector involvement will lead to a higher level of integrity in impact investing and better framework conditions. They consider risk capital participation by the public sector to be particularly important, and according to the interviewees, it is especially relevant to attract institutional investors to impact investing.

In order for the Swiss ecosystem to grow even closer together, it is recommended to promote exchanges between the two financial centers of Geneva and Zurich and to establish long-term partnerships between development organizations and the financial world. There are voices that expect that in the future impact will be part of the consideration of every investment, just like risk and return. If this happens, the entire Swiss financial center will one day be able to benefit from the pioneering role of impact investment.

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