

# PLACE-BASED IMPACT INVESTMENT IN AUSTRALIA





Written by Ingrid Burkett, Knode, April 2012

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Building Blocks for Action

# PLACE-BASED IMPACT INVESTMENT IN AUSTRALIA

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THIS REPORT IS A COLLABORATION BETWEEN:



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JBWere

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This is a companion document to ‘*Place-based Impact Investment in Australia – a Literature Review*’, which provides an overview of Impact Investment, how it could be applied to address issues of underserved communities and why such investment could have significant impact in addressing place-based joblessness in the Australian context. This current document sets out the key building blocks for Place-based Impact Investment in Australia – it focuses on opening up discussion about how such an initiative could be designed and implemented in the Australian context. There is some overlap in the two documents so that they can function as stand-alone reports, however it is recommended that they be read in conjunction with each other so that readers are able to get the best overview possible of Place-Based Impact Investment.



## DEPARTMENT OF EDUCATION, EMPLOYMENT AND WORKPLACE RELATIONS (DEEWR)

DEEWR's strategic policy objectives are to contribute to a productive and inclusive Australia. This work highlights opportunities to increase investment in under-invested communities to promote regeneration and jobs and to develop and diversify the market for investments, which target strong social as well as economic outcomes. DEEWR has also led development and implementation of Australian Government initiatives in impact investment, in

particular the Social Enterprise Development and Investment Funds (SEDIF), which have also sought to increase appropriate finance available to under-served markets – social enterprises – and provide a catalyst for development of impact investment in Australia. Thanks to Ingrid Burkett for her thoughtful work and to our partners National Australia Bank, JB Were and Mission Australia.



## NATIONAL AUSTRALIA BANK (NAB)

National Australia Bank is a major financial services company with 25,000 employees in Australia and provides quality products and services, fair fees and charges, and relationships built on the principles of help, guidance and advice. Core to NAB's corporate

responsibility agenda is a commitment to build stronger communities with the provision of financial services for all Australians, including those that may financially excluded from mainstream banking.



## MISSION AUSTRALIA

Mission Australia's involvement in this project stemmed from an organisational drive towards finding new and innovative ways to create a fairer Australia.



## JBWERE

JBWere is pleased to be involved with this project as part of our commitment to supporting the philanthropic and not-for-profit sectors in Australia. Our Philanthropic Services business works with public

and private businesses, not-for-profit enterprises, Governments, and philanthropic clients to develop innovative ways to put funding into the community via a variety of social investment alternatives.

## ACKNOWLEDGEMENTS

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## GLOSSARY OF ACRONYMS

ABS	Australian Bureau of Statistics
AHURI	Australian Housing and Urban Research Institute
CDFI	Community Development Finance (or Financial) Institution
CDVC	Community Development Venture Capital
CITR	Community Investment Tax Relief (UK)
CRA	Community Reinvestment Act (USA)
DVC	Developmental Venture Capital
DEEWR	Department of Education, Employment and Workplace Relations (Australia)
ESOP	Employee Share Ownership Plan
ICIC	Initiative for a Competitive Inner City (USA)
IPO	Initial Public Offering
IRR	Internal Rate of Return
NfP	Not-for-Profit Organisation
NMTC	New Market Tax Credit program (USA)
NRAS	National Rental Affordability Scheme (Australia)
PE	Private Equity
PEA	Priority Employment Area (Australia)
SEDIF	Social Enterprise Development Investment Fund (Australia)
SME	Small to medium sized enterprise
VC	Venture Capital

# PLACE-BASED IMPACT INVESTMENTS:

*Focussed on particular places that can generate impacts and may be underserved by traditional investment.*



Investments in specified localities that intentionally

*Provision of capital and other resources with the expectation of a return.*



*The generation of a positive impact is purposefully designed into the investment process, rather than merely being a side-effect of the investment.*





The investment is focussed on double- or triple-bottom line outcomes, with positive social impacts being tracked and reported to investors, and investors seeing social impacts as part of their decision-making process.



generate positive social impacts and financial returns



Investors expect a financial return from their investment (ie. this is not a gift or philanthropic donation). The return varies across a spectrum, from return of principal plus small interest, to market comparable returns.

# Executive Summary

This is an opportunity to collaborate in catalysing new and innovative investment strategies that create real change in Australia's underserved communities.

It is an opportunity for investment leaders and visionaries looking to take the first steps towards building new markets that generate impacts in addition to returns.

## THE OPPORTUNITY

Place-based Impact Investment presents an opportunity for innovative investment approaches that focus on place, explicitly seeking to generate both an impact in communities *and* financial returns for investors. There are two core reasons why such approaches present an opportunity for Australia:

- In Australia's accelerating two speed economy some communities are being left behind, experiencing economic decline and under-investment, resulting in a concentration of disadvantage. Place-based Impact Investment has the potential to make a significant contribution to addressing under-investment in Australia's declining communities.
- There is increasing demand for investment that not only offers financial returns but also makes an impact socially and environmentally. Place-based Impact Investment has the potential to develop new markets in areas that may previously have been bypassed or not reviewed.

International experience demonstrates that Place-based Impact Investment can reverse the spiral of under-investment while also generating a financial return for investors. Significant opportunities exist for developing such approaches in Australia, particularly for 'first movers' who could lead and catalyse this emerging market. This document outlines some core building blocks for harnessing these opportunities, and proposes some possible strategies for enacting these approaches in Australia.



## PURPOSE

Place-based Impact Investment approaches bring an investment lens to addressing community decline and under-investment in Australia. These approaches seek to reverse the cycle of under-investment and foster economic renewal in those communities that are at risk of, or already in decline, distress or disadvantage, and

in so doing prevent further decline and restore economic vitality. This section demonstrates that it is possible to build an investment proposition around this vision, incorporating appropriate financial risk and return considerations.



PAGE 20–23

## FOCUS

Place-based Impact Investment is focussed on making a real difference in places that have been left behind. One of the key indicators of decline and disadvantage in Australian communities is concentrated and persistent joblessness. To address this, Place-based Impact Investment has a geographic focus (Australia's underserved communities and those communities at risk of

decline) and a sector focus (centred on the role of SMEs as key employers and creators of employment, and other sectors that could be considered as a complement or alternative, such as property).



PAGE 24–33

## STRUCTURE

Place-based Impact Investment presents an opportunity to target a range of investors with different priorities and appetites for different risk profiles through innovative structuring. Appropriate structuring is a critical part of the ultimate success of Place-based Impact Investment as this creates the bridge between capital and impact. Internationally there are growing numbers of examples of

institutional and retail investors investing in place-based programs through debt, equity and mezzanine finance products. Case studies demonstrate how appropriate structuring can ensure that significant social impact flows from these investments whilst also generating returns for investors.



PAGE 34–43

## PERFORMANCE

Impact Investors increasingly seek social impact performance reports in addition to financial results. An emerging international Impact Investment Infrastructure is helping to focus such reporting

on standards and benchmarks. This can be adopted by Place-based Impact Investment as it develops in Australia.



PAGE 44–49

## POSSIBLE STRATEGIES

Three possible strategies for Place-based Impact Investment in Australia are outlined, focussed on investment in start-up businesses; established, high-growth potential businesses; and commercial property.

These strategies draw together both international learnings and the exploration of what is needed in the Australian context and provide a foundation for building successful Australian Place-based Impact Investment Initiatives.



PAGE 50–65



# Introduction

This document outlines the building blocks for Place-based Impact Investment in Australia, including possibilities for some early funds. The intent is both to illustrate the potential and also to serve as a call to action to explore and develop the opportunities for this type of approach to produce genuine financial, economic and social outcomes. The approach deliberately provides both a financial perspective and the conditions for successfully achieving impact in communities.

There is sufficient track record and examples overseas to paint the possibility for the Australian market.

## SEEDCO FINANCIAL

Seedco Financial is a Community Development Financial Institution with over \$70 million in assets under management. They operate a small business loan fund that lends to businesses employing people in underserved areas in Alabama, New York and Louisiana. They also offer technical assistance to SMEs in these areas. In 2010 their investments created around 600 jobs and retained 250 existing jobs in underserved areas. Investors include banks, financial institutions, foundations and government.

## BRIDGES VENTURES

Bridges Ventures Community Development Fund in the UK manages two venture funds (totalling £115 million) that invest in businesses located in the most disadvantaged 25% of the UK, and in businesses operating in sustainable sectors. Through these investments they have generated and retained almost 1400 jobs in these communities, and generated £4.10 in additional spending in target areas for each £1 invested. Exit returns to date range from 29–165% IRR.

## PACIFIC COMMUNITY VENTURES

Pacific Community Ventures manages three venture funds totaling US\$60 million that invest in mid to later stage businesses with growth potential, capacity to create jobs and potential to contribute to economic growth predominantly in underserved communities in California, US. Over the last decade they have created 5000+ jobs through their investments, with 2/3 of employees of invested companies residing in underserved areas. PCVs second fund realised a gross IRR of 28.3%.

### CEI

Coastal Enterprises Inc (CEI) manage a \$10 million venture fund that invests in growth-oriented businesses located in underserved areas of Maine, USA. Through these investments they create quality employment opportunities for people on low incomes, promote progressive management practices, support socially beneficial products and services, enrich distressed communities and foster environmental sustainability. Historically CEI have generated returns of between 11% and 20%.

These opportunities have potential to reverse cycles of under-investment and decline in communities to create jobs and stimulate local economies [Social Investment Taskforce UK; Bridges Ventures 2010, 2011]. They could also contribute more broadly to building Australia's economic competitiveness by mobilizing knowledge and skills and driving growth and innovation [Tomaney, 2010; Horrigan, 2011].



This is a companion document to '*Place-based Impact Investment in Australia – a Literature Review*', which provides an overview of Impact Investment, how it could be applied to address issues of underserved communities and why such investment could have significant impact in addressing place-based joblessness in the Australian context.

# Context

The international evidence has been reviewed and applied to the Australian context in the companion *Literature Review: Place-based Impact Investment in Australia*. The underlying case for Place-based Impact Investment highlights opportunities to aggregate and structure investments responsive to increasing demand for socially and environmentally responsible investment and develop markets in areas which may previously have been bypassed or not reviewed. These opportunities to generate financial return *and* have meaningful impact on the economic infrastructure of Australia's communities focus on the convergence of some key global strategic directions.

- *Place-based approaches* are gaining currency internationally as a mechanism for growth and human capital development and can contribute to tackling irregularities across the economy and reduce inequality [see for example Tomaney, 2010; Byron, 2010]
- *Clustering* can create virtuous economic cycles based on geographic concentration of enterprise, building local markets and capability and contributing to innovation [see for example, Corrigan, 2011; Porter, 1990];
- Addressing barriers for *investment in small to medium sized enterprises*, which collectively are the largest providers of employment and generate the most new jobs [see for example, Halabisky et al, 2006; OECD, 2009];
- Following *parallels in recognition of asset classes for clean technology and green buildings*, encouragement of new businesses in other growth segments such as health and well being and innovative delivery of education and training [see for example, Bridges, 2011];
- The emergence of *Impact Investment as a growth market* with sufficient track record

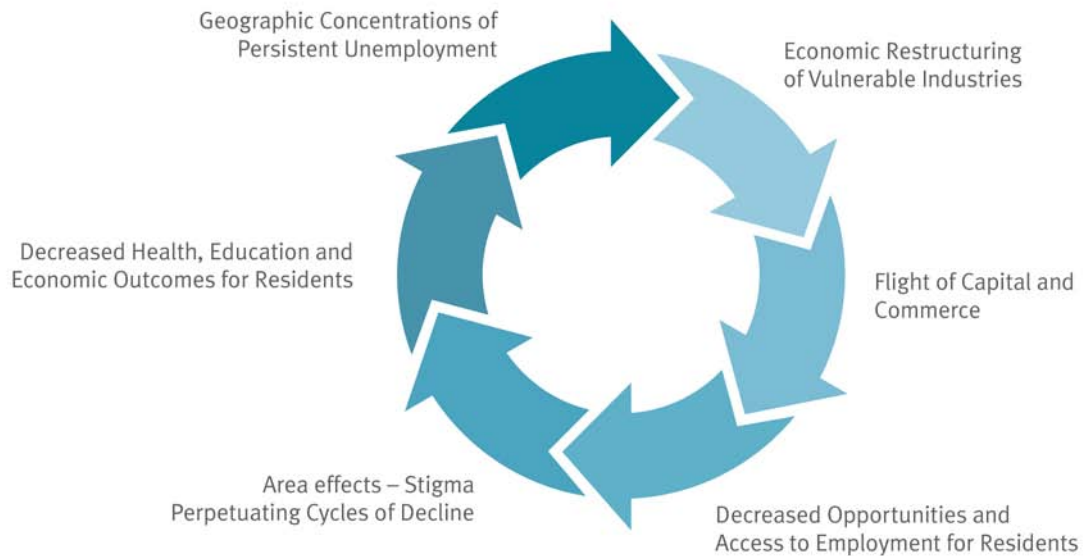
internationally to start attracting mainstream investment and gain recognition as an alternative asset class offering quantifiable investment return, assessable risk and potential for diversification [see for example Sultak et al, 2011].

In Australia's accelerating two-speed economy, some communities are being left behind. Correspondingly, potential and markets in these communities are not being developed. Despite Australia's growing wealth and its strong economic position in international markets, some communities are experiencing economic decline and under-investment, which leads to social decline and concentration of disadvantage.

## ***In Australia, disadvantage has a postcode.***

Further, economic and structural adjustments over recent years have affected particularly those communities and regions where industries such as manufacturing are concentrated. This has negative consequences not only for individuals and families, but also for communities, for businesses, and for society. It is crucial to address the issue of under-investment in these communities [see *figure 1*].

One of the key indicators of decline and disadvantage in Australian communities is persistent and concentrated joblessness. In some communities such concentration of joblessness has been heightened by a combination of economic restructuring, decline of particular industries, a crowding-out of private investment and a decline in opportunities and access to new jobs.



**Figure 1**

*The cycle of economic decline in communities*

***Solutions to under-investment and market failures need to incorporate innovations that go beyond welfare.***

The evidence and a substantial body of international practice highlights to a need for solutions that incorporate wealth-creation strategies rather than only focussing on increasing income and services for people in underserved areas. This points the way for structuring opportunities to develop underutilised potential in these areas where markets are not currently operating effectively, or which for a range of reasons have been bypassed or not considered.

In Australia, as elsewhere, most new jobs are created in small and medium sized businesses (SMEs). Yet SMEs are experiencing increasing difficulty accessing the capital they need to operate and retain jobs, let alone develop and grow to create new jobs. In addition strategies are needed to address the unique challenge of the expected retirement of a record number of baby-boomer heads of family owned SMEs over the next 4–5 years [Seet & Graves, 2010].

A key way to address the issue of under-investment is to generate opportunities for economic renewal and the creation of new, quality jobs in those places experiencing decline and disadvantage. There are a range of possibilities with a track record internationally to structure investment into SMEs in underserved areas, thereby providing both debt and equity options, meeting a need for working capital, asset development capital, risk capital and growth capital. This in turn strengthens SMEs, enabling them to develop and grow, retain existing local jobs and creating the potential for these SMEs to generate new jobs in underserved communities.

***This presents an opportunity in the shape of innovative investment approaches that focus on place, explicitly seeking to have an impact in communities while generating financial returns that can be structured as an investable proposition.***

# The opportunity

Place-based Impact Investment presents an innovative investment approach that can revitalise underserved communities, create economic opportunity *and* deliver real and sustainable financial returns for investors.

Place-based Impact Investment presents opportunities for investors with a range of investment intentions. Investment opportunities can be structured to accommodate those seeking firstly to generate financial returns with the added benefit of meaningful impact in communities; and those looking first to make a difference for communities, who may also seek some financial return. In fact, structures which allow for participation of investors with different intentions may provide potential to optimise both impact and returns [see for example, Freireich and Fulton, 2009].

The vision of Place-based Impact Investment is to intentionally and carefully channel private investment into under-invested communities to generate positive social impacts (such as job creation and strengthening local economies) in addition to generating financial returns for investors.

The practical considerations outlined in this document centre on utilizing a range of traditional and well understood financial mechanisms based around debt and equity. What is different is a focus on *place* and on generating social impact as well as financial return. This document outlines a number of suggestions for expanding or more fully utilizing the versatility of financial instruments to better meet the needs of both the target market (SMEs in underserved communities) and the appetites of investors seeking impact as well as financial return.

Also included is consideration of the approach or services which may be required as an adjunct to capital or financial products for such approaches to be successful (such as business planning or capacity-building for SMEs). This also is not new and has parallels in venture capital and incubation in other sectors. However, what will be required to genuinely meet the needs of SMEs and other sectors in underserved local communities will require development in Australia. Here again there are lessons from the overseas experience and other sectors.

Place-based Impact Investment creates opportunities for genuine cross-sector innovations and partnerships. Not only can appropriately targeted philanthropic and grant capital play a role, but skills and resources of different sectors also have complementary roles to play.

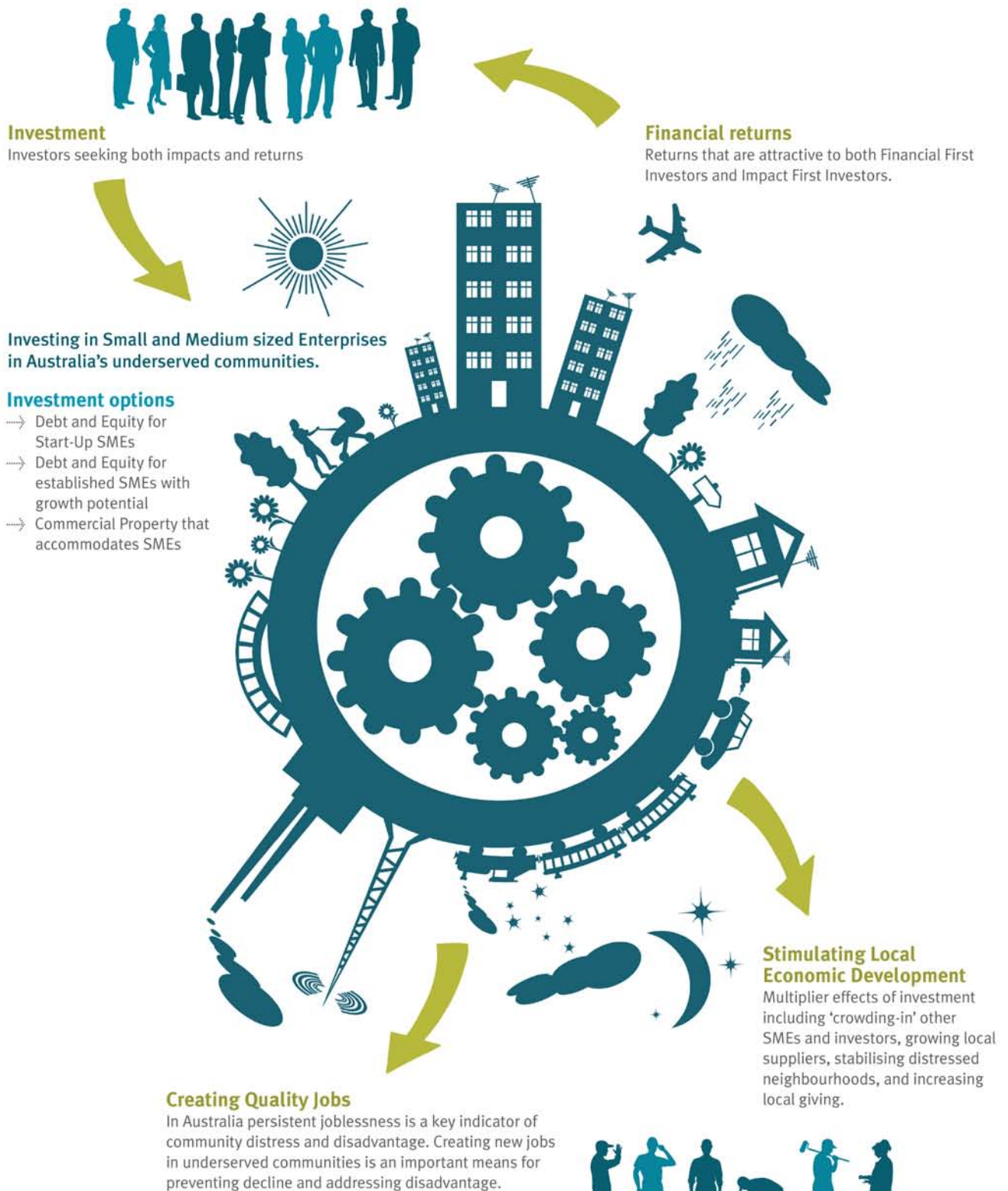
For example, employment initiatives and training programs may contribute to development of an appropriately skilled local workforce. Similarly, private equity and employee ownership initiatives may provide valuable experience in developing options for buy out of family owned SMEs with no current succession plan [see for example the Australian Employee Ownership Association, [www.aeoa.org.au](http://www.aeoa.org.au)].

The international experience points to a range of structuring options, which involve achieving a balance between social impact and financial return as well as balancing expected risk and return profiles depending on the nature of the investment (for example, equity investment in aspirational start up business compared with mortgage backed debt facilities for property investment).



## PLACE-BASED IMPACT INVESTMENT

Generating positive social impacts in underserved communities and delivering financial returns to investors.



*Developing innovative investment approaches that transform communities and lives*

That variety and range is also reflected in the documented indications of expected and realised returns across Impact Investments as an asset class [see *table 1*]. The performance of particular Place-based Impact Investment initiatives is considered in the individual case studies included in this material. The infrastructure needed for investors to assess and compare

Impact Investments across these factors is emerging internationally [see for example the Global Impact Investment Network (GIIN) [www.thegiin.org](http://www.thegiin.org)] and as this develops there will no doubt be further discussions about how impact and returns come together to shape the purpose of Place-based Impact Investment.

## IMPACT + RETURNS

- ✓ *Develop investment solutions for underserved communities;*
- ✓ *Build real pathways out of persistent unemployment;*
- ✓ *Revitalise distressed and under-invested communities;*
- ✓ *Create economic opportunity;*
- ✓ *Contribute to building strong local communities for the new economy.*
- ✓ *Real and comparable financial returns;*
- ✓ *Investment opportunities in undervalued and overlooked markets;*
- ✓ *Potential for investors to engage with emerging markets;*
- ✓ *Opportunities for a range of investors with different impact and return expectations – Impact First and Financial First.*

1 – These figures are based on a longitudinal analysis by JP Morgan of both internal and external index data across debt and equity funds in ‘developed’ or ‘Global North’ countries (ie. they do not include data on Impact Investment in emerging economies or the Global South). Case studies throughout this report will indicate that there are examples of Impact Investment returns outside this range, but that in general these figures do reflect the range of reported returns in the Impact Investment sector.

Impact Investment Instruments	Average realised returns (gross annual IRR or yield)	Range of expected returns reported (gross annual IRR or yield)
Debt	0–5%	1–14% [2010] –3–11% [2011] (4% average expected return)
Equity	15–20%	1–30% [2010] 5–33% [2011] (19% average expected return)

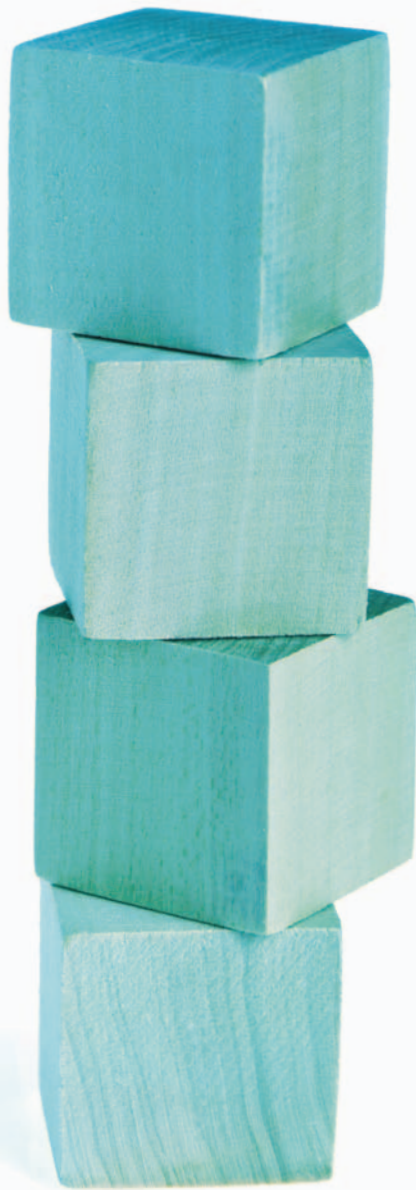
*Table 1*

*GIIN and JP Morgan analysis of expectation and realisation of financial returns in Impact Investment incorporating 2010 and 2011 survey results*

*Source – O'Donohoe et al, 2010; Saltuk, 2011; JP Morgan, 2011<sup>1</sup>*

In order to provide the foundations for action, parts of this document provide the outlines of a blueprint for action, and other parts provide options, or point to key areas for development and dialogue for Place-based Impact Investment to become a reality in Australia. The document sets out four building blocks that are essential

to developing Place-based Impact Investment in Australia, and outlines options for each. These building blocks are outlined briefly below. The document concludes with an overview of three potential strategies for implementing Place-based Impact Investment in Australia.



## PURPOSE

Clearly sets out the investment objectives.

## FOCUS

Articulates the target market for the demand side of the investment in terms of place and sector.

## STRUCTURE

The bridging of demand and supply sides across the investment cycle. Products need to be designed to ensure that purpose is satisfied within the identified areas of focus.

## PERFORMANCE

Measures the social impact generated through investment in underserved communities to ensure that the purpose of the investment is achieved.

# PURPOSE

## Clearly sets out the investment objectives

An Impact Investment design must begin with the identification of a desired social impact and then structure an investment proposition and related processes to achieve that, incorporating appropriate financial risk and return considerations.

Impact investment takes the ‘Environmental, Social and Governance’ screens in socially responsible investment a step further and intentionally seeks to generate social or environmental impacts as well as financial returns. So, by definition, the impact sought

needs to be a clear focus. Designing the purpose should answer the question: ‘why are we doing this and what are we hoping to achieve?’ It leads to an articulation of the intended impact that underpins Place-based Impact Investment and an intentionality about why using an investment approach could achieve or contribute to that impact. Place-based Impact Investment approaches seek to reverse the cycle of under-investment and foster economic renewal in those communities that are at risk of, or already in decline, distress or disadvantage, and in so doing to prevent further decline and restore economic

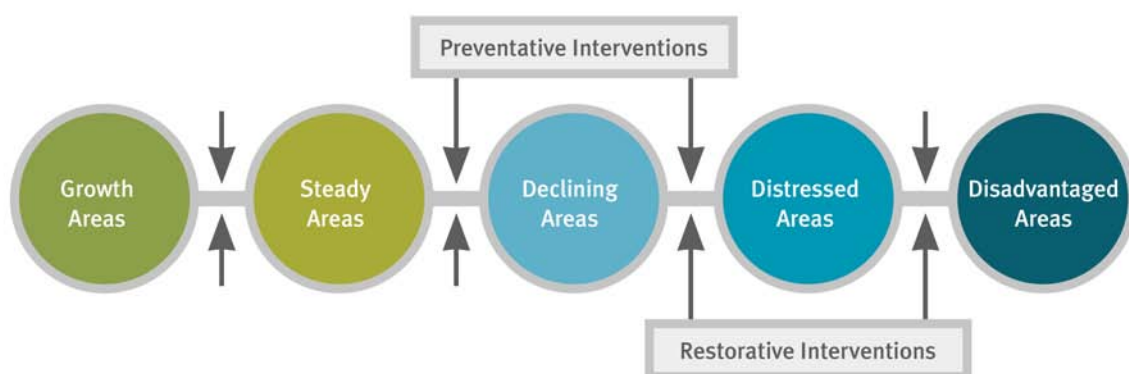


Figure 2

Place-based Impact Investment can have a Preventative or Restorative Purpose

vitality. Place-based Impact Investment can have a preventative and/or a restorative agenda [see *figure 2*]. Bringing an investment lens to addressing disadvantage opens possibilities for solutions beyond welfare, and creates opportunities for both residents and investors to develop real pathways out of decline and under-investment. It is important to be clear whether the purpose is restorative or preventative as this has an impact on other design factors.

### An Example of an articulation of Place-based Impact Investment Purpose –

*‘PCV believes that aiding SMEs in low income communities will produce strong social and economic outcomes in the form of quality jobs, business and financial networks and entrepreneurial role models. PCV believes that having a constant store of quality employment opportunities is the only sustainable way to lift local communities out of poverty’*

Pacific Community Ventures, undertaking Place-based Impact Investment in California’s low income communities

*[Caplan et al, 2007]*

### Building intentionality of Impact into the Investment requires –

- ➔ Understanding why communities are under-invested and underserved;
- ➔ Building the information needed to provide capital into an underserved market in a way that generates both impacts and returns;
- ➔ Developing an appreciation of what other resources (beyond investment capital) are needed to achieve the impact.

In Australia, decline and disadvantage are very much linked to demographic, structural and commercial shifts [see *figure 3*]. In particular, persistent and concentrated joblessness is a key indicator of decline, and this often leads to under-investment and eventually to place-based disadvantage.

Addressing this requires an acknowledgement of the broad social changes that lead to decline; a vision for change that draws not only on the deficits of a place but is grounded in its assets; and a recognition of the potential benefits of

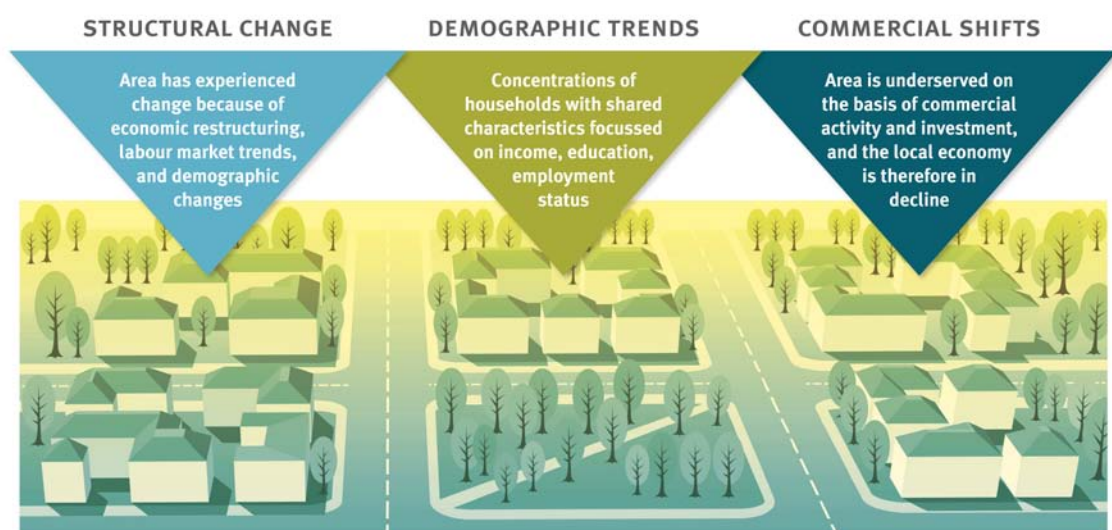


Figure 3

Place-based Impact Investment responses require an understanding of more than demographic trends





Figure 4

The benefits of Place-based Impact Investment flow back to all stakeholders

Place-based Impact Investment that flow to all stakeholders.

#### Structural and Commercial Change Effect Investment

Understanding how structural changes and commercial shifts impact on communities is critical to building Place-based Impact Investment, as these factors impact particularly on how investment flows into and around communities. Responses to these shifts need to go beyond tracking demographic trends and welfare responses. Creating employment opportunities, improving health and wellbeing and increasing training and education all contribute to building and strengthening local economies and addressing decline, including joblessness [see, for example the impact focus of the Bridges Ventures funds, 2011].

#### Need for an Asset-Focussed Approach

Linking investment to the creation of economic opportunity requires a focus on the assets,

underutilized potential of an area, the potential ‘upsides’ and investment opportunities. Place-based Impact Investment therefore needs to take an asset-focussed approach, not merely a deficit approach to place. Linking an asset focus with an investment approach has the potential to stimulate innovative businesses and latent entrepreneurial capacity.

#### Benefits flow to all stakeholders

Internationally it is clear that investing in the revitalisation of declining communities through Place-based Impact Investment provides both direct benefits and multiplier effects to these communities and their residents. It also provides flow-on benefits for businesses, public services and civic organisations in and around those communities. The benefits and value from engagement in Place-based Impact Investment therefore flow back to all stakeholders – investors, government and not-for-profits [as outlined in figure 4].

### And What of Returns?

Discussions of purpose cannot be completed without consideration of financial returns that are expected and could be realised for such investments. By definition, the purpose of Impact Investment includes generating a financial return. The level of return sought and required will need to reflect not only the nature of the investment proposition (eg. at its most straightforward, debt or equity), but also the investors intention for balancing between impact and financial return. Further, the impact objectives sought will

relate to the return and risk profile of any given investment in different ways. This in turn will shape and be shaped by the investment structure and strategy. Impact Investment ultimately seeks a degree of complementarity between the risk/return profiles of a particular investment and the impact that it can potentially generate. The science of Impact Investment lies in how the investment structure and strategy can ensure that returns and impacts can co-exist and indeed be positively correlated such that the purpose of the investment can be realised.

“

*‘My biggest concern is that the proposition for impact investing ends up being more about the potential financial returns on capital than about why the capital is being invested in the first place. The risk is that the focus is more on financial return as an end in itself rather than as a tool and a means to solve big intractable social problems. Right now the debate is often framed by the financial return an organization can make rather than by the goals of that organization and the best capital structures to realize those goals. I think the debate would be more effective if we framed it around the latter’.*

*Jacqueline Novogratz, Acumen Fund, Stanford Social Innovation Review: Roundtable on Impact Investing, Winter, 2012*

*‘Key to the success of impact investments is the fact that they are investments expected to generate a financial return. This aim should co-exist with the intent toward positive impact, though one or the other may be the primary focus for a given investor. In fact, the pairing of these two motivations by investors will hopefully encourage businesses to develop in financially sustainable ways, thus facilitating the growth of the impact delivered by those businesses’.*

*JP Morgan and Rockefeller Foundation, 2010, p.15*

”

## // PURPOSE — Key design questions

- What is the intended (social) impact: Why are we doing this and what are we hoping to achieve?
- Is that intended impact preventative or restorative?
- How do our impact goals for Place-based Impact Investment relate to the returns and the risk profile our investors or potential investors are seeking? How will this shape the investment strategy and structure?

# FOCUS

Articulates the target market for the demand side of the investment in terms of place and sector

This section outlines the design considerations for both a geographic and sector focus in Place-based Impact Investment:

- **Geographic Focus** – explores a framework for identifying which communities in Australia are underserved / under-invested and how this could be applied;
- **Sector Focus** – examines why SMEs are an appropriate target for Place-based Impact Investment and other segments or sectors which could be considered as a complement or alternative.

## GEOGRAPHIC FOCUS OF PLACE-BASED IMPACT INVESTMENT

Given that Place-based Impact Investment is centred on addressing decline and under-investment in communities, any design needs to articulate a framework for how such communities are to be identified and how the criteria are to be applied. Specifically, it is important to be clear in this context whether the intention is preventative or restorative, as that will impact the target areas. It is uncommon for Place-based Impact Investment initiatives to focus on one locality; most initiatives are structured as investment funds and target a range of localities which

meet specified criteria (eg. Bridges Ventures targets communities in the most deprived 25% of communities in the UK according to the UK Government's Index of Multiple Deprivation (IMD))

In the US and the UK where targeted economic development investment has existed for some time, the criteria used focus on various indicators, and are based on recognised indices which are published by government sources [as shown in *table 2*].

In Australia the most commonly applied national data set used to identify areas of disadvantage is the Australian Bureau of Statistics' Socio-Economic Indexes for Areas (SEIFA). This data is organised by postcodes; local authorities; and regions. Other resources include studies on place-based disadvantage [see *Literature Review*] which point to criteria which could be incorporated into a design for the Australian context.

An effective framework for identifying geographic focus in Place-based Impact Investment needs to be broad enough to ensure that a diversity of investment opportunities would be available, but not so broad as to be meaningless from an impact perspective.



United Kingdom	United States
<p>Place-based Impact Investors such as Bridges Community Ventures, use the UK Government's <b>Index of Multiple Deprivation (IMD)</b> which focuses on measuring place-based deprivation across the following indicators:</p> <ul style="list-style-type: none"> <li>→ Health deprivation and disability</li> <li>→ Income deprivation</li> <li>→ Education, skills and training deprivation</li> <li>→ Employment deprivation</li> <li>→ Barriers to housing and services</li> <li>→ Crime</li> <li>→ Living environment deprivation</li> </ul>	<p>The US has a <b>legal definition for a low-income geographic area</b>, used for directed social and economic policies, including Place-based Impact Investment:</p> <p>Any population census tract (or the equivalent county division) where:</p> <ul style="list-style-type: none"> <li>→ the poverty rate for that census tract is 20% or more;</li> <li>→ if it is located within a metropolitan area, 50% or more of the households in that census tract have an income equal to less than 60% of the area median gross income; or</li> <li>→ if it is not located within a metropolitan area, the median household income for such tract does not exceed 80% of the statewide median household income; or</li> <li>→ as determined by the Administrator based on objective criteria, a substantial population of low-income individuals reside, an inadequate access to investment capital exists, or other indications of economic distress exist in that census tract; or</li> <li>→ it is defined as being a specific zone in legislation or by authority for the purposes of economic development or recovery.</li> </ul>

Table 2

*Definition of target areas for economic development investment in the UK and US*

Sources – UK Department of Communities and Local Government [www.imd.communities.gov.uk] and US CDFI Fund [www.cdfifund.gov]

## Defining the Focus in Place-based Impact Investment has three key functions –

- To develop **market knowledge** – Investment in particular markets requires market and sector knowledge (particularly if that market is underserved). Therefore identifying the target market is a critical foundation for developing the knowledge and understanding needed to effectively invest in this market;
- To help define **impact performance** – measuring impact and assessing what difference has been made requires a clear articulation of the focus of Place-based

Impact Investment (eg. performance reports often discuss how many jobs were created or retained in underserved areas as a consequence of an investment);

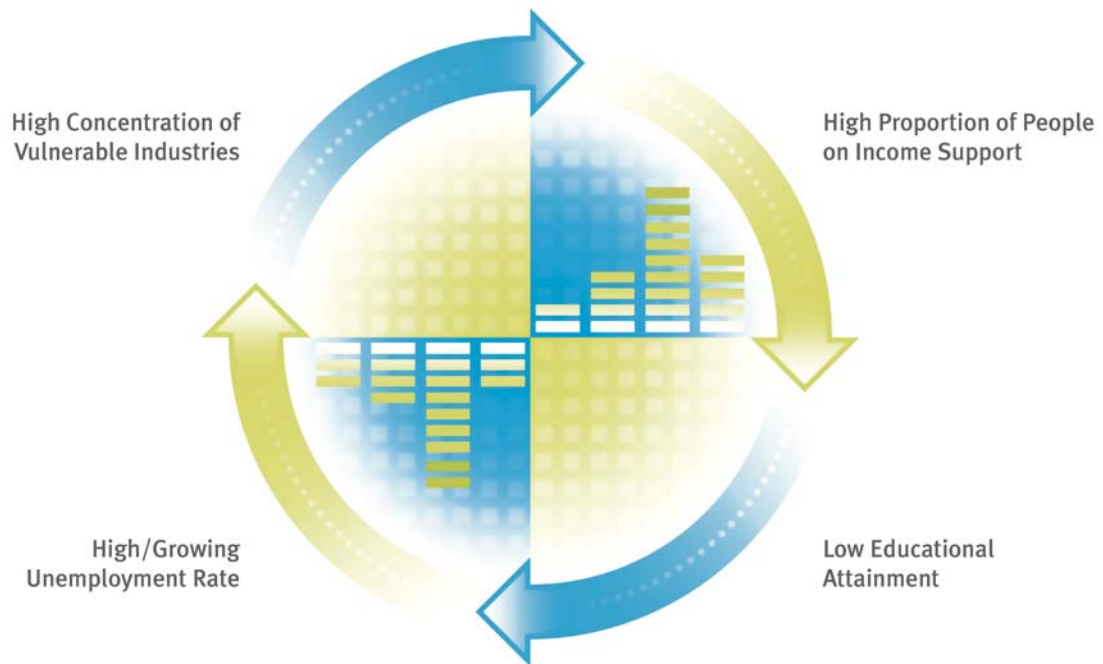
- To help design the **investment strategy** – the design of an investment strategy requires a detailed understanding of the focus and purpose of Place-based Impact Investment, creating the foundations for how impact and return can be incorporated into investment processes.

“

*‘If place does not matter, then loans ... are isolated, random transactions that fail to add up into anything more than the sum of the promissory notes’.*

*Cascadia Enterprises, focussed on Place-based Impact Investment in Oregon and Washington, US*

”



**Figure 5**

*An overview of key indicators used to identify PEA regions*

A regional framework incorporates both postcodes and local authorities (and these narrower identifiers could add specificity in impact measurement), and offer breadth and greater diversity of opportunities from an investment perspective.

For this reason, a **regional framework** for identifying the geographic focus for Place-based Impact Investment in Australia is the preferred identifier level. Regional analyses are, of course, built from data collected at postcode or local authority level, but these are aggregated to identify areas that share particular characteristics. This overcomes disadvantages that more local data may:

- Be too narrow to optimise diversity in investment opportunities;
- Evoke investor discrimination on the basis of perception rather than a careful analysis of investment opportunity;
- Not yield a critical mass of investment opportunities.

Perhaps the most relevant regional analysis in relation to identifying underserved areas is the Federal Government's Priority Employment Areas (PEA) framework. This framework identifies

regions that are experiencing structural and labour market stress, and are therefore at risk of decline or distress during economic downturns. While they are part of Federal Government Policy, these regions have been identified using key data at household and industry levels, and therefore the framework and metrics could be adapted to create a geographic base for Place-based Impact Investment. The indicators used to assess the Priority Employment Areas (PEAs) are outlined in *figure 5*.

In order to strengthen the PEA framework for the purposes of Place-based Impact Investment two additional elements could be considered. First, threshold rates could be added that indicate when an area is declining, along with an objective assessment of how many indicator thresholds an area would need to exceed in order to be defined as an eligible target area (as in the US definition). Development of thresholds within the indicators would enable an assessment and ranking of how deep the decline or disadvantage is, and whether a preventative or restorative investment approach is needed. It may not be the case that declining areas exceed all thresholds, rather, there may be certain thresholds that, in combination, indicate decline. So, for example,

not all PEA regions have unemployment rates above the national average, but in examining those that don't, it is clear that other factors (such as the: scale of increases in unemployment rates over time; age profile; skill base of the population; and the proportion of people employed in vulnerable industries) indicate decline or significant risk when considered in combination with each other [for data on key indicators for PEA regions see *appendix 1*].

Second, regions could be ranked according to the level of decline they are experiencing (integrating, for example, data from SEIFA which ranks areas according to their overall level of disadvantage). This may give investors an indication of the depth of impact their investments are likely to generate. It would also assist in targeting and distinguishing a focus for preventative and restorative purposes.

Finally building a picture that includes commercial analysis of these areas would assist in developing the investment proposition. This could be added using business activity data, and could be enhanced through use of property price data, commercial lending activity data and other key commercial metrics that could help

identify shifts and trends related to capital and investment flows.

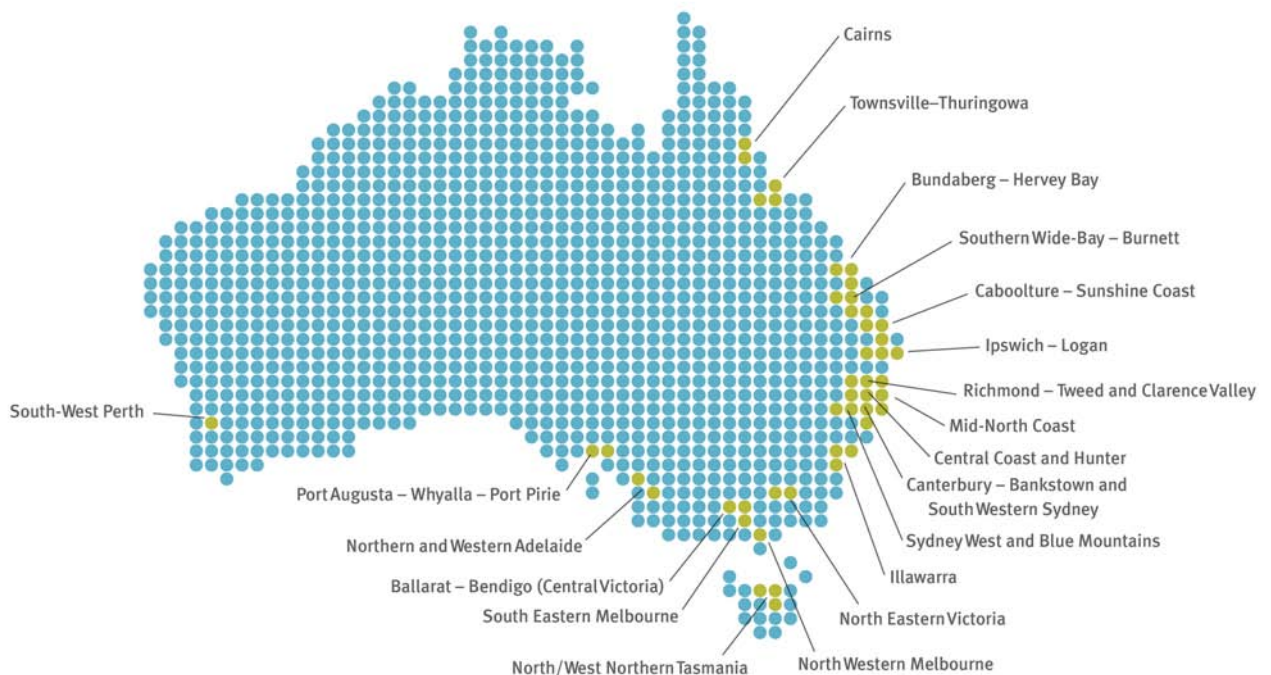
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*'Bridges Ventures was founded with the conviction that by building thriving, responsible businesses in underserved areas ... we could create commercial returns and long-lasting social benefit. In fact, our belief is that the two can go hand-in-hand: companies that meet society's pressing needs tend to have fast growth potential; while those that behave responsibly can sustain and enhance that growth over time'.*

*Bridges Ventures Impact Report, 2011*

”

There are currently twenty identified PEA regions in Australia [see *figure 6*]. If the framework was expanded to include thresholds and commercial analyses, it is likely that more areas would be identified as under-invested.



**Figure 6**

A map of current Priority Employment Areas as defined by DEEWR

The compilation of comprehensive data sets focussed on these areas goes beyond the scope of this project, however the next section does examine some SME business data in relation to PEAs.

Making the assessment framework public and transparent and therefore open for review would be an important aspect of a Place-based Impact Investment approach. It is also critical for linking measurement of impact to purpose.

### SECTOR FOCUS IN PLACE-BASED IMPACT INVESTMENT

As with other investment propositions, articulating a sector focus is important, particularly to allow for portfolio comparability and to place the investment opportunity within an asset class. SMEs are proposed as a key sector classification for Place-based Impact Investment for the reasons outlined here and in the *Literature Review*. The other sectors considered here are complementary, particularly property assets to support development, clustering and stability for SMEs in underserved communities. However this focus should not be interpreted as limiting or presenting an exhaustive list of the potential opportunities. Some place-based funds internationally have focussed on other sectors including housing, real estate, education and training, or health and wellbeing [see for example, Bridges, 2011].

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*‘Small businesses which tend to be independently and locally-owned often play a vital role in generating and retaining wealth in local economies’.*

*Price Waterhouse Coopers, 2007;p.vii*

”

Other opportunities may focus on the potential for Place-based Impact Investment in the environmental, clean and renewable energy sectors [see for example, Murdi Parki Green Skills report DEEWR 2011].

In determining the sector focus an investment design should consider the purpose of using investment as a mechanism for achieving impact, the potentials for generating returns and impact, and the benefits that can be derived from the broader environment, including potentials for supply development, demand development and direction of capital [see *Literature Review* for further details]. Considering all these factors in the Australian context has led us to conclude that SMEs represent a potentially significant sector focus for Place-based Impact Investment in this context.

### Four key reasons why SMEs provide an excellent sector focus for Place-based Impact Investment –

- ➔ Collectively SMEs in Australia represent a significant employer, and more importantly, a critical generator of employment opportunities across industry sectors;
- ➔ SMEs in Australia make a substantial contribution to local economies in addition to the national economy, therefore investing in SMEs has the potential to generate multiplier effects in underserved target communities;
- ➔ Over half the SMEs in Australia are family-owned, and one in four family-owned businesses in Australia is led by someone over the age of 55 [ABS, 2007], meaning that a significant number of SME owners will be looking for exits in the next decade, opening opportunities for investors, but also posing a potential employment risk if such exits do not result in sales or transfers of the businesses [see for example, Seet and Graves, 2010];
- ➔ An identification of need and opportunity for both debt and equity capital in Australia's SME sector signifies a potential pipeline for investment.

### Sector Analysis of SMEs

In Australia, SMEs have played a vital role in: generating employment; contributing to the national economy; and, in creating viable and sustainable local economies. As a focus for Place-based Impact Investment, they have the potential to deliver significant impacts and positive financial returns.

### SMEs and Employment

SMEs employ almost half of Australia's workforce. Collectively they are the largest providers of employment and the greatest contributors of new jobs. Most job creation occurs in companies with high growth potential, so-called 'gazelles'. While there are some arguments that young firms create more jobs, it is now widely accepted that more established SMEs actually create more quality, sustainable jobs because they are less likely to fail and are better able to offer better security, wages and other benefits. SMEs also open more employment opportunities for people with lower skills, and those with lower educational attainment. They are therefore considered to be excellent entry-points for people into employment.

Interestingly, in Australia firm size is not emphasised in the analysis of employment projections, as it is in other contexts. Therefore it is difficult to analyse the actual or potential contribution of start-up SMEs to employment growth, either generally or specifically in target areas. The development of such data could help to provide both a rationale for Place-based Impact Investment, but also provide an important analytical starting point for any initiatives seeking to invest in SMEs in target areas.

Any Place-based Impact Investment design should take account of the types of businesses that are thought to generate the highest quality employment. That is:

- Small to medium sized businesses;
- Established companies;
- Ambitious businesses with high growth potential.

### SMEs and Local Economic Development

Australian SMEs tend, more than larger or multinational corporations, to be connected to place. Therefore SMEs play an important role not only in Australia's macroeconomic landscape, but also in local economies.

This is important in terms of the design of Place-based Impact Investment. The indirect impacts of how investment contributes to growing dynamic local economies and thereby how economic opportunities for residents are opened, are just as important in addressing decline and disadvantage as creating jobs. These indirect impacts relate to:

- The quantum of wages that can flow from SMEs into the local economy (through the employment of local people);
- The local spend in the supply chain of an SME can help to grow other local businesses and thereby contribute to the overall economic development of an underserved area;
- A strong and growing SME can act as an attractor for other businesses into an area, thereby crowding-in more economic activity and potentially generating further jobs and local development;
- Robust locally based SMEs tend to give more charitable donations locally, thereby helping to strengthen place-based civil society, again adding to the well-being of the local economy.

Thus, investing in SMEs based in underserved areas generates not only direct effects through job creation but has local multiplier effects that impact on whole communities [see for example, New Economics Foundation, [www.neweconomics.org](http://www.neweconomics.org); Civic Economics, [www.civiceconomics.com](http://www.civiceconomics.com)].

### Family-Owned SMEs in Australia

There is a particular emerging need and opportunity for investment in family owned SMEs as the baby boomer generation reach retirement age. Over half of Australian SMEs are family-owned, and family-owned businesses make a significant contribution to both the national economy and are a recognised sub-set of the SME sector.

Recent research estimates that 60% of family business owners plan to retire by 2016 but around half of these owners will not be able to pass on these businesses because of a lack of suitable successors [Seet and Graves, 2010].

Emmerson [2006, in Seet and Graves, 2010;p.8] estimates that 'an average of one family business will be sold or closed down daily in Australia in the next decade'. Thus, some have described the situation as an 'impending crisis' that will affect



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*‘An estimated 60% of Australian family business owners plan to retire by 2016 as part of the predicted retirement of the post-war baby-boomers but about half of them will be unable to pass the business onto the next generation due to a lack of available and/or suitable successors. Not all family business owners can look forward to traditional exit options such as trade sales, and therefore alternative succession strategies, such as the involvement of private equity, need to be considered’.*

*Seet and Graves, 2010;p.7*

*‘It is estimated that the total value of family-owned businesses in 2006 was A\$4.3 trillion, which represents a greater value than the total of the ASX market capitalisation of all listed companies plus the total value of all managed funds in Australia’.*

*Price Waterhouse Coopers, 2007;p.iii*

”

employment in local communities, the economies of these communities and the Australian economy as a whole [Seet and Graves, 2010].

There are opportunities in this scenario for Place-based Impact Investment, which could assist in the ownership transition of some of these companies in underserved areas to both protect and grow local jobs. Exploring Place-based private equity options in this space has the potential for helping to avert a crisis, and also for achieving local impacts and delivering financial returns for investors. Further, there are international examples with a track record in targeting such businesses, including the use of approaches that encourage employee ownership [see for example, Pacific Community Ventures in Caplan et al, 2007]. The opportunities for exploring these strategies in Australia are significant.

### **Need for SME Capital**

Access to capital is key to SME viability and growth, and in Australia much of the capital that is available to SMEs is limited to bank finance, that is, loans secured against residential property.

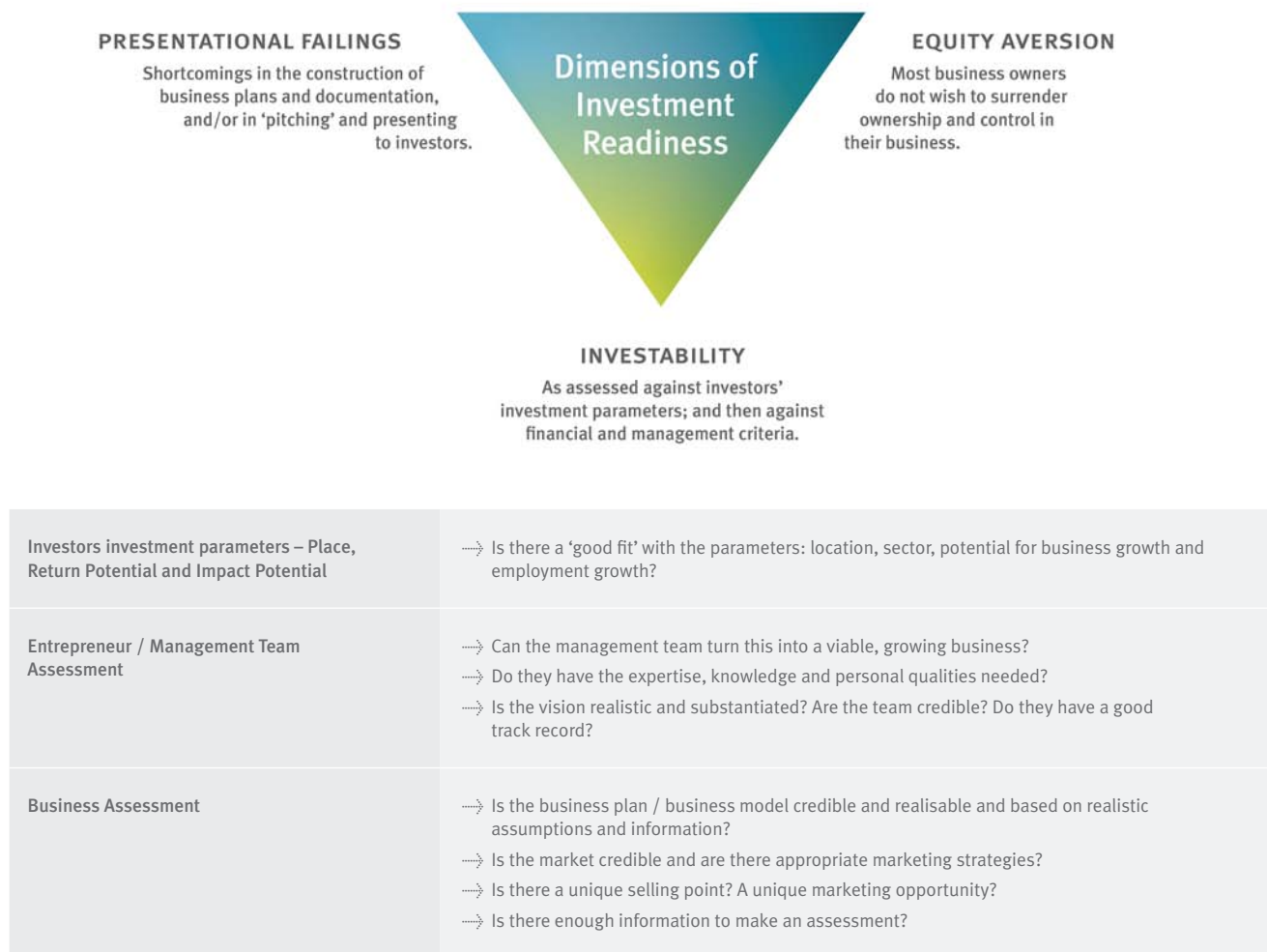
While in overseas contexts equity funding is considered an equally vital part of ensuring SME success and development, this has not generally been the case to date in Australia where equity capital has been limited both because of regulatory and cost constraints. Small scale personal offers under the Corporations Act [2001]

restrict capital raises to a total of \$2 million raised and 20 investors (ie. the ‘20/12’ rule) and detailed and prescriptive rules making even this difficult. Further, high costs involved in capital raises through Offer Information Statements or Prospectuses, or via listed offers mean that such options are out of the reach of most SMEs.

An alternative option for SMEs seeking equity capital prior to listing on the stock exchange is The Australian Small Scale Offerings Board (ASSOB) which is a unique capital-raising platform for unlisted companies seeking between \$200,000 and \$5 million. ASSOB also acts as a secondary market whereby investors can offer their shares for public sales as an exit option. This option will be further explored in the next section as it potentially offers some interesting possibilities that warrant further exploration for Place-based Impact Investment. It is raised here for the purposes of signaling that there is both a need and a potentially large pipeline for the development of investment options in SMEs within Australia – as ASSOB has demonstrated, having raised over \$120 million in SME capital since its national launch in 2004 [see [www.assob.com.au](http://www.assob.com.au)].

### **How Investable and Investment Ready are SMEs in Australia?**

While there may be a pipeline for investment into SMEs, the key questions lie not only in the need for and supply of capital but also in the capacity and investability of the SMEs. Therefore, in designing Place-based Impact Investment



**Figure 7**

*Three dimensions of investment readiness in SMEs*

*Source – Based on Mason and Kwok, 2010*

focused on SMEs it is crucially important to consider the demand-side of investment – that is, how investment-ready SMEs are and whether they have the capacity to generate a financial return for investors. Much of the work done internationally on investment-readiness has focussed on equity investments, but it applies equally to an SMEs' capacity to take up debt capital. The dimensions of what constitutes 'investment readiness' are illustrated in *figure 7*.

Assessments of Australian SMEs in terms of investment-readiness have not been undertaken on a broad-scale for over a decade [see Ernst and Young, 1997]. However it is likely that there are still major gaps in investment-readiness for many SMEs in Australia – capacity gaps, knowledge

gaps and attitudinal gaps related to accessing non-debt finance.

Addressing SME 'investment readiness' is a key part of ensuring a demand-side investment pipeline and thus should be a consideration in any design for Place-based Impact Investment. There are a range of established approaches to assisting SMEs to: identify and assess financing options; become investment-ready by understanding what investors are looking for and undertaking action so that investors are able to access the information they utilise in making investment decisions; having access to business support and critical diagnosis from experts; and, linking SMEs to investors [Mason and Kwok, 2010; pp.33–34].

### Potential for Property as a Sector Focus

Investments in property in underserved communities has certainly demonstrated possibilities for catalysing local economic development in overseas contexts. Indeed the UK Social Investment Taskforce, when recommending a place-based fund approach noted that:

*‘Since property redevelopment is a vital component in the regeneration of areas suffering from under-investment, it would be helpful to consider, in due course, whether the CDV (Community Development Venture) Funds should also have the ability to invest up to one third of their capital in property assets and the balance in businesses’* [Creating wealth Beyond Welfare Taskforce Report 2000].

Property has certainly become a sector focus for Place-based Impact Investment in overseas contexts, particularly in the US and more recently in the UK. This is explored further in the strategies section at the back of this report.

### Other Potential Sector Foci

As outlined in the *Literature Review*, Place-based Impact Investment could also focus on generating impacts in other areas that are linked to decline in Australia – such as, for example, education and skill development; health; transport; or housing. These sectors are increasingly visible in Place-based Impact Investment internationally [see for example, Bridges, 2010 and 2011], and could also be further explored in the Australian context.

### Linking a Geographic and Sector Focus

Effectively linking a geographic and sector focus when designing a Place-based Impact Investment initiative may require building an understanding of the nature and size or potential for the relevant sector in or around the targeted areas. Such analysis should neither over nor under estimate the potential for a well designed investment proposition to generate innovative approaches and overcome market failures. For example, if considering potential for investment in SMEs in underserved communities, it is important to understand the nature and size of SMEs in the targeted communities and also the impact that access to capital may have on stimulating growth and ambition for enterprises. Further, such analysis should also explore the potential of Place-based Impact Investment to aggregate opportunities for investment which

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*‘When PCV began investing its first Fund in 1999, it focussed on early-stage companies in underserved markets that have \$250,000 to \$3 million in annual sales. ...PCV sustained financial losses from these early investments, learning valuable lessons in the process ... Bricks and mortar SMEs targeted by PCV usually do not exhibit the same potential for exponential growth, a rapid exit and financial return on investment. In the face of this more measured return environment, the risk associated with PCV investing in very early-stage companies combined with having limited control, did not translate to a sustainable investment strategy’.*

[Caplan et al, 2007p.10-11]

*‘All 2006 PCV Portfolio companies with annual revenues over \$5 million provide exceptional or good quality jobs (including paying living wages, benefits, wealth-building opportunities and skill-based training) to designated employees, compared to 90% of companies with revenues between \$1.5 million and \$5 million and 75% of companies with revenues under \$1.5 million’.*

[Caplan et al, 2007;p.33]

”

may be too small individually but may enable a dynamic portfolio approach in aggregate. As outlined earlier, one of the identifying features of underserved communities in Australia is a concentration of vulnerable industries. This may also reflect the types of SMEs that are located in these communities, with manufacturing being amongst the top five industries in all PEA regions except the most rural areas.

Across Australia the three dominant SME business types are: Construction, Professional and Technical Services, and Rental, Hiring, Real Estate. In Priority Employment Areas (PEAs) the dominant SME business types are: Construction,



Retail and Manufacturing in urban areas, and Construction, Retail and Agriculture in rural areas. In PEAs these also represent the highest employing industries.

In terms of SMEs located in Priority Employment Areas, the vast majority would be counted as small, with around 80% of businesses in these areas having annual turnovers of less than \$5 million [ABS, 2011]. For investments focussed beyond debt capital (ie. private equity and mezzanine finance) such turnovers may be considered too small, both in terms of impact and return potentials. A number of Place-based Impact Investment funds focussed on private equity overseas have argued that businesses with annual turnovers between \$5 million and \$50 million have greater potential for such investments (and interestingly also tend to generate more significant impacts in terms of quality jobs in underserved communities) [see for example, Caplan et al, 2007]. For more detail about the number of SMEs with turnovers between \$5 million – \$50 million in PEA regions see *appendix one*.

This points to the need for Place-based Impact Investment to consider the nature of the SME market in underserved communities and to

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*‘...the equation isn’t as simple as capital + small business = jobs ... Capital alone will not ensure business survival, let alone propel growth’.*

*Beth Sirull, Pacific Community Ventures, 2010*

”

frame investment around not only those industries that are performing well financially, but those with potential to introduce new areas for growth and those that are most likely to employ people from the local region. This is why many Place-based Impact Investments in other contexts are focussed on ‘brick and mortar’ industries vital to local economies and job creation – such as niche manufacturing, food and beverage companies, health and well-being services, environmental services, and hospitality, for example. Similarly, it is important to ensure that property sector investments actually drive impacts for residents in underserved communities rather than merely resulting in their displacement as property prices rise.

## // FOCUS – Key design questions

- What areas are targeted and how do these link to the purpose, in particular whether the intent is preventative or restorative?
- What indicators should be used to identify the geographic focus and what thresholds should be used to assess the depth of decline in a community?
- Do these indicators and thresholds constitute an effective framework for identifying geographic focus in Place-based Impact Investment – is the framework broad enough for a diversity of investment opportunities but not so broad as to be meaningless?
- What is the sector focus and how will it shape potential impacts and returns?
- What demand-side interventions may be needed to ensure the target sector in the designated areas are investment-ready? Who will undertake these interventions and how will they be funded?
- How does the combination of a geographic focus and sector focus shape the strategies and structures?

# STRUCTURE

The bridging of demand and supply sides across the investment cycle. Products need to be designed to ensure that purpose is satisfied within the identified areas of focus.

Appropriate structuring is a critical part of the ultimate success of Impact Investment and the focus on place raises some particular considerations. Merely making more capital available to SMEs or promoting investment into underserved areas will not necessarily create new opportunities for these communities. Particular care needs to be taken in structuring for the intended purpose to ensure that benefits flow to residents and local businesses, and that there is not significant displacement of people or removal of assets from the community. Appropriate performance reporting can create transparency and accountability around this [see for example, Bouri, 2011]. When the impact is centred on markets that have been under-invested, structures also need to take particular account of existing information asymmetries and obstacles to the flow of capital.

Structuring is about the 'how-to' of Impact Investment. The elements of structure together create the bridge between supply and demand

sides, and between capital and impact. At its core, designing an Impact Investment structure needs to address the question of whether the investment products are debt or equity based and the implications this then has for both demand and supply-side structuring. Structuring then also needs to address the following elements [see *figure 8*]:

- ➔ *How to structure an institutional framework* that can create a bridge between investors and underserved markets, developing the specialist skills and knowledge needed to really make a difference and deliver returns;
- ➔ *How to structure the investment cycle* from deal sourcing to exit in such a way that the impacts and returns can be optimised;
- ➔ *How to structure investment opportunities* so that investors with different expectations and intentions can participate in bringing about real change in underserved communities.



Figure 8

The Elements of Structuring Impact Investment to Generate Impacts and Returns

### DEBT VS. EQUITY

It may appear trite to suggest that a fundamental structuring question is whether the nature of the investment products is debt or equity. However, this question is particularly central in the context of Impact Investment for the reasons outlined below.

There are strong arguments developing that Impact Investment may need to develop as an ‘intermediate’ capital market, at least from an investor perspective. [see for example, Saltuk et al, 2011; Evernett & Richter 2011], that is:

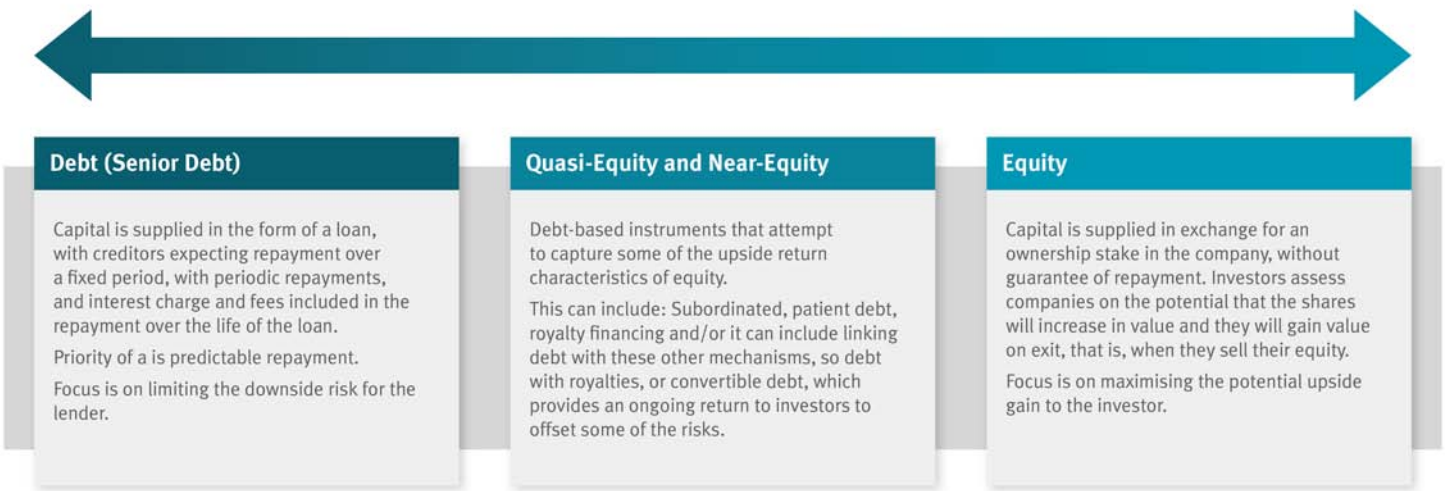
*‘...comprising risk capital and more straightforward working capital as well as development capital and property finance, and incorporating a spectrum of different types of debt capital and quasi-equity ... much of the current social impact investment activity already takes place in this intermediate capital space and is by way of debt ... Debt is a highly versatile instrument when structured as intermediate capital with flexible term sheets. Rather than being a single product in itself, debt consists of a spectrum of capital from ‘plain vanilla’ mortgage-like secured loans to nearly equity-like products.’* [Evernett & Richter 2011]

Funding mechanisms may include private equity, debt, mezzanine finance and quasi-equity patient capital structures, and/or debt tied to cash flows or growth (such as royalties). There are, in other words, a range of ways in which capital could be structured for investment. In effect, such approaches could open up a spectrum of options for capital in target areas, ranging from debt, to quasi equity and through to equity models. This spectrum is illustrated in *figure 9*.

Assessment of the most appropriate forms of capital and associated mechanisms that could support the targeted impact and return is fundamental. What is called for is a mix of traditional forms of growth and working capital and more innovative approaches.

Growth-oriented capital in the context of SMEs includes:

➔ **Growth oriented working capital** – short-term loans that open opportunities for increasing profit in an SME (for example, lending for rapid expansion when a contract has been won but payments are yet to be made; expansion capital for inventory; leasing finance when short-term leases of plant, equipment or vehicles are required to



increase work flow). Growth-oriented working capital is different from working capital that is focussed more on day-to-day survival and smoothing cash flows. While the latter may be necessary for business survival and for retaining staff during difficult periods, they are not classed as growth-oriented working capital as they do not necessarily create opportunities for growing and developing the business.

- **Asset development capital** – longer-term loans focussed on the acquisition / purchase of plant, equipment, vehicles, or fixed assets such as land and buildings, that are used to grow and develop the SME;
- **Growth capital** – long-term mezzanine and equity capital structured to allow an SME to develop and grow.

Access to growth-oriented debt capital is critical for SMEs in the current Australian context, and many overseas examples of Place-based Impact Investment focus on purely debt based structures (indeed one researcher suggests that as much as 98% of the assets invested in by CDFIs in the US are structured through debt [Thornley, 2012, personal communication]).

This should be considered in relation to designs of Place-based Impact Investment in Australia. However, it is important also to consider innovative approaches to debt, and to examine investment structures beyond debt in the Australian context.

An example of the innovative use of debt in the context of SMEs is a royalty structure which allows for repayments to be structured around future performance and growth (rather than collateral and past performance) [Hamilton, 2009]. Such structures can also be useful when exits present impact or return challenges, as payments are made from an SMEs cash-flow. Further, the SME maintains ownership under such an arrangement, which may be important to owners or to maintaining local ownership in a target area [Hamilton, 2009]. The case study 'Vested for Growth' examines a Place-based Impact Investment fund that structures such 'mezzanine finance' deals in established SMEs.

In other situations, investments are better structured towards the equity end of the spectrum, and these funds (referred to either as growth funds or venture funds) look for opportunities to invest in established businesses in target areas, with returns built around growth in the value of the business over time and realised on exit. This has consequences in the context of structuring the investment cycle, considered below.

Some overseas research has demonstrated that the size of a company's revenue is important in assessing their need for equity-based growth capital (with Thornley [2012 – personal communication] suggesting that 'the need for growth equity kicks in at about US\$2 million of revenue').

As discussed in the last chapter, in Australia access to equity capital for SMEs is very difficult for cost reasons and because of the strictness of capital raising regulations. Place-based Impact Investment could open opportunities for SMEs located in Australia's underserved communities to access equity and equity-like capital and thereby build their capacity to grow and create jobs in those communities.

An innovative Australian initiative that assists SMEs to gain access to equity capital without the large costs that are usually involved is the Australian Small Scale Offerings Board (ASSOB). There may be potential for exploring potential for links with ASSOB through Place-based Impact Investment [see *next column*].

If property were to form a sector focus the structural questions centre more on whether such investments were structured as loan funds or property funds, and in the case of the latter, on the structure of exits. This is further explored in the potential strategies for Place-based Impact Investment at the end of this report.

### Case Study

#### Vested for Growth

Vested for Growth is an initiative of the New Hampshire Community Loan Fund, a CDFI based in the US. Established in 2002, Vested for Growth offers customised growth capital for established 'high impact' SMEs in New Hampshire that use a combination of subordinated debt and royalty. They focus on value-adding businesses, mainly niche manufacturers who offer unique products or services and that charge more for a brand premium. Most of the SMEs that they invest in have between 20 and 50 employees and between \$2 million and \$10 million in sales. The royalties are structured so that investors receive between 0.25% and 3% of sales. Vested for Growth addresses a financing gap for growth capital. Many of the SMEs in which they have invested were rejected by banks for debt capital because of insufficient collateral, problems in sales or profitability over the past three years, a concentration of sales or bankruptcy – but who have a good margin on their products/services [Hamilton, 2009]. They are also businesses that are not interested in equity options because they do not wish to sell or dilute their ownership stake, are not wanting to lose control of decisions or because their projections are not large enough for equity owners.

[see [www.vestedforgrowth.com](http://www.vestedforgrowth.com)]

### Potential for Place-based Impact Investment Partnership

The *Australian Small Scale Offerings Board* (ASSOB) was conceived by its founding Chairman, Tony Puls, as a way for small businesses to gain access to growth capital, without the prohibitive expenses of listing on a stock exchange. ASSOB was designed as a mechanism for SMEs to move beyond bank loans as sources of capital for development and growth and to access equity-based growth capital in the form of unlisted securities. ASSOB has class order exemption from ASIC in relation to the Section 708 of the Corporations Act [ASIC Class Order 02/273], making it possible to raise up to \$5 million instead of the \$2 million permitted under the 20/12 rule, and also reducing the requirements for full disclosure documents, making it much more accessible and affordable for SMEs. ASSOB is essentially a capital raising platform for unlisted companies, and 'facilitates the origination, aggregation and sale of securities', both through primary issues and secondary sales [Ling Hui, 2009;p.2]. It operates as a 'Business Introduction Service', connecting SMEs looking to raise equity capital, with potential investors. The ASSOB process involves companies linking with an authorised ASSOB sponsor, who provides business and governance advice, ensures the company has an appropriate share capital structure and financial credentials and writes a compliant offer document. ASSOB is a compliant, affordable and effective way of addressing the 'equity gap' that SMEs in Australia face in their growth and development. For many SMEs it is a stepping stone for growth prior to listing on a stock exchange.

If Place-based Impact Investment in Australia is to develop around approaches to investing in established high-growth SMEs in target areas, there may be some merit in exploring the possibilities of connecting with ASSOB as an established mechanism for accessing growth capital for unlisted companies. At the very least any Place-based Impact Investment initiative in Australia would do well to gain accreditation as an ASSOB sponsor to open possibilities for SMEs in target areas to benefit from this growth capital stepping stone.

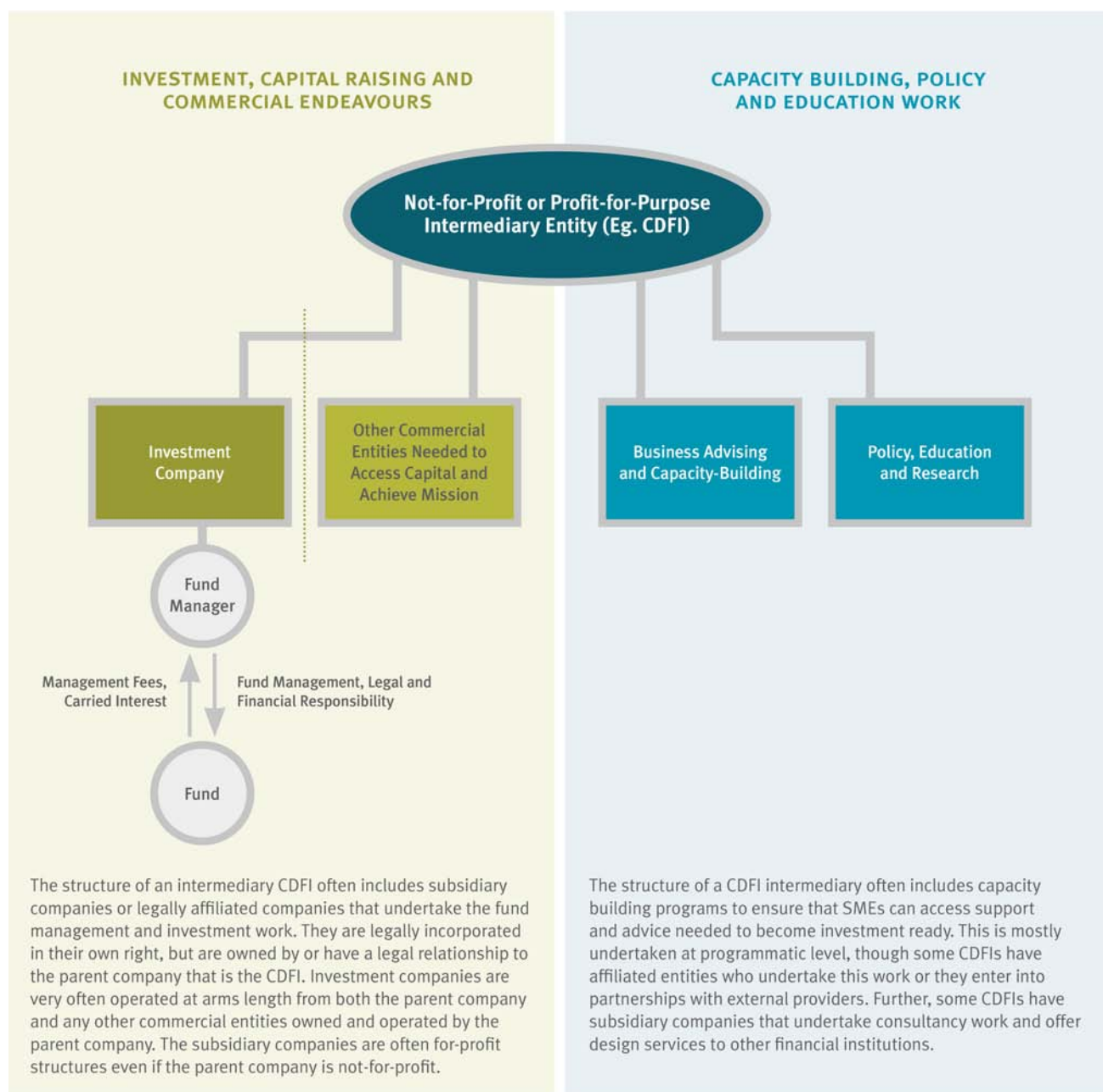


Figure 10

The multiple structures within intermediaries to optimise social impact generation and financial returns

### STRUCTURING THE INSTITUTIONAL FRAMEWORK

The categorization of Impact Investment as an intermediary market extends to some of the structures that have developed to facilitate the achievement of social and environmental impacts as well as strong financial performance.

This has spawned a number of hybrid or mixed structures combining for profit and not for profit entities to enable balancing of mission and market. Some of these innovations have been championed particularly by intermediaries such as Community Development Financial Institutions (CDFIs) in places like the US and the UK. Further innovations have also been achieved through



regulation, which has had an impact on the flow of capital to underserved communities [see *Literature Review*].

Many intermediaries such as CDFIs, and some more specialist equity focussed intermediaries such as Community Development Venture Capital funds (CDVCs), are structured in such a way as to ensure that both supply-side and demand-side needs can be addressed within the institutional structure. This means that many CDFIs not only manage funds, but may also open opportunities for building the capacity of SMEs or providing a range of SME financing options to build investment readiness, to ensure that their impact mission is achieved. These functions are almost always at arms length from the fund management work to avoid conflicts of interest in credit related processes. However, the combination of these different functions within institutional structures underpin the overall success of Place-based Impact Investment initiatives and in this way the development of a supporting intermediary market has contributed to more integrated supply and demand-side activities. *Figure 10* outlines the elements of such structures.

Impact Investment intermediaries need to be structured to:

- Ensure the flow and supply of capital (in all forms) into funds by attracting a range of investors with different objectives;
- Apply the rigour of the market and clear intentionality for impact to optimise the

potential for generating both financial returns and social impacts;

- Build and grow the Impact Investment market and ensure a pipeline of investable and investment-ready demand side opportunities.

Within the Impact Investment market, funds and intermediaries adopt structures that incorporate a diverse range of skills and experience and, where appropriate, both for-profit and not-for-profit entities. Other approaches involve mature partnerships between fund managers and entities that help them to fulfill a broad range of objectives. Examples of some of the creative structures in the market are set out in *table 3*. Regulatory considerations also have an impact on the institutional structure, though innovations are also developing in the international landscape to recognize structures that can more easily accommodate both mission and market [see for example Community Interest Companies in the UK [[www.bis.gov.uk/cicregulator](http://www.bis.gov.uk/cicregulator)] and Benefit Corporations in the US [[www.bcorporation.net](http://www.bcorporation.net)]].

Other versions of these ownership structures may also be possible in the Australian context. For example, an investment company or fund could be initiated and co-owned by a consortium of non-profits, or a private-public partnership, or through a cross-sector partnership arrangement. If the partners also co-invested in the fund this may be attractive to a broader cross-section of investors, and could more effectively utilise the strengths of different stakeholders.

Ownership Option	Example
Non-profit ownership	<i>Kentucky Highlands Investment Corporation</i> (KHIC) is a non-profit parent company, a registered CDFI. It has developed for-profit subsidiaries that can ensure it has access to capital in the future. The subsidiaries include a Small Business Investment Corporation, an industrial real estate development corporation, and a management consulting company.
Blended ownership: partly non-profit and partly private	<i>Bridges Ventures</i> is majority owned by its executive directors and the Bridges Charitable Trust (the latter also having control over any changes to the company's social mission). The directors also donate part of their own profits into the trust.
Private ownership	<i>DBL Investors</i> is a small venture capital firm based in San Francisco, US, whose name stands for 'Double Bottom Line', meaning that they seek financial and social return in their investments. The company is also the only female-run venture capital firm in the US.

*Table 3*

*Ownership options for Place-based Impact Investment Intermediaries*

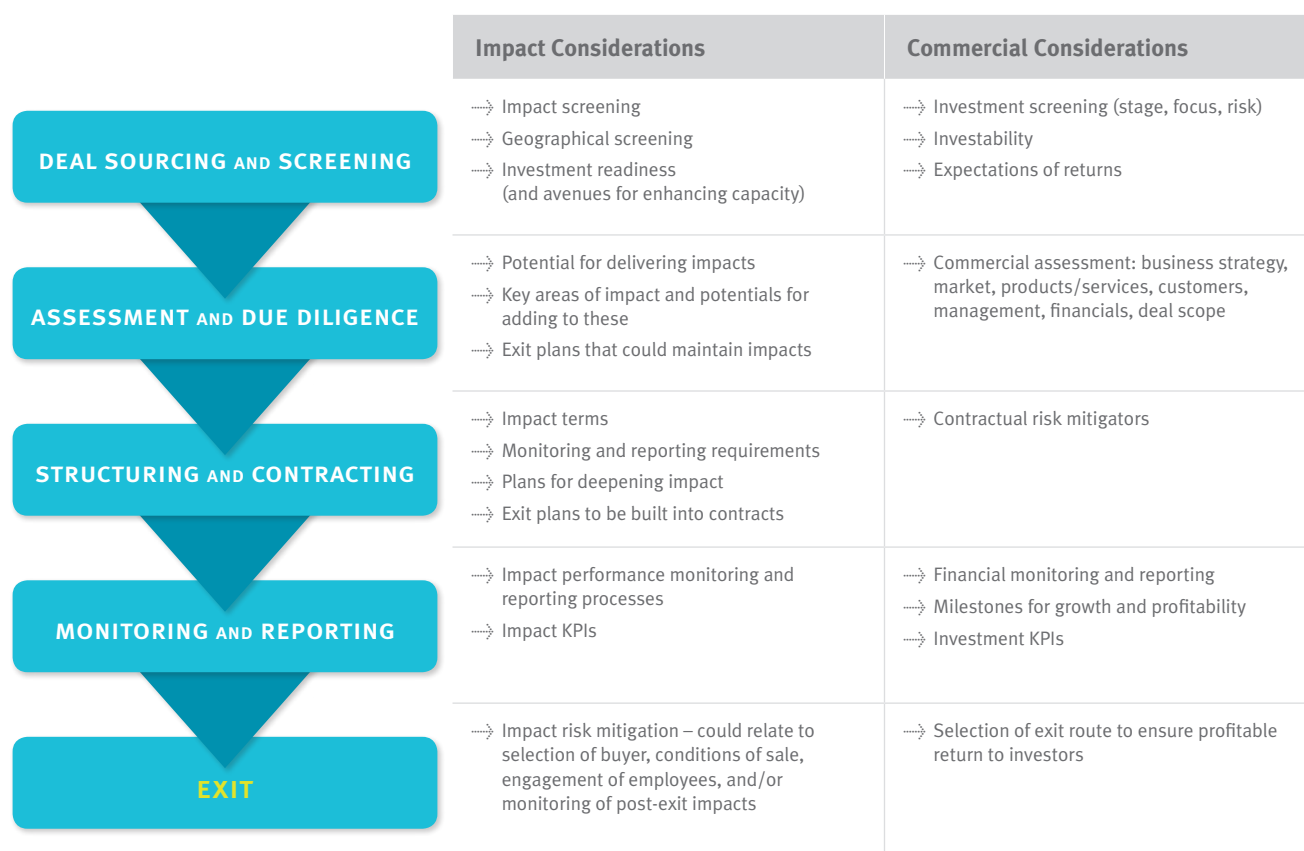


Figure 11

Structuring the Investment Process to Consider both Impact and Returns

Source – Based on Grabenwarter and Liechtenstein, 2011;p.28

## STRUCTURING THE INVESTMENT CYCLE

An investment cycle often begins with sourcing potential deals and then applying a screening processes that either screens-in investments that a fund wishes to explore further, or screens them out because they do not fit the profiles investors wish to focus on. Investors then make particular kinds of assessments of the potential investments that are screened in, and decide if they are indeed investable or of interest to the fund. If they are assessed positively, and the investment is made, the next phase of the cycle involves the ongoing monitoring and evaluation of the investment, and then eventually an exit from the investment [see figure 11].

At each of these stages in the investment cycle, consideration needs to be given to both impact and return. Therefore Place-based

Impact Investment involves the commercial considerations that are key to any investment assessment, but in addition, takes account of impact considerations throughout the cycle. The challenges and the potentials for innovations in Impact Investment lie in the weighting of these considerations across the investment cycle, and the ways in which these considerations can lead to an innovative synthesis.

For example, a number of Place-based Impact Investment initiatives have developed innovative impact-focussed screening methodologies that sit alongside commercial screens to provide as much information as possible about the potential of a deal to generate impacts over the course of the investment cycle. Such impact screens focus particularly on assessing the potential social impacts that could be generated from the investment (such as the number and quality of



jobs that could be generated, and the potential for economic multiplier effects) [see case studies on Bridges and CEI].

Although there have been concerns amongst Impact Investment professionals about the challenges of exits when social impact is at the heart of an investment, with careful structuring and planning on the part of fund managers and support staff, exits can realise both impacts and returns. Further, methodologies for structuring impact expectations into investment contracts, and for intentionally planning for optimal social impacts beyond the investment exit have also been developed.

The case studies below illustrate how this has worked in three different venture funds investing in established SMEs in underserved areas. They also provide an insight into how innovative approaches to structuring impacts into the investment process, alongside commercial tools, helps to ensure that both impacts and returns are generated throughout the investment cycle.

### Case Study

#### Coastal Enterprises Inc

Impact Investment often requires particular strategies for deal sourcing and screening. Coastal Enterprises Inc (CEI) subsidiary venture capital fund (CEI Community Ventures) uses a pro-active and direct approach to deal sourcing using business directories, chamber of commerce listings, local newspapers and other methods to identify opportunities, educate and inform potential SMEs on venture capital as a tool for growth. CEI also uses a mapping application that identifies SMEs in underserved areas and allows CEI to review them according to their sector, size and key personnel.

CEI uses screening tools and expectation agreements to 'help deals better achieve the organization's overall goals. It conducts a low-income job assessment for large loans and equity investments that examines the quality of the jobs through a questionnaire and interview process' [Bailey, 2008;p.14].

These processes help CEI's venture fund to identify potential deals in underserved areas and also to ensure that investments will generate impacts in these communities, and helps to ensure that the PCVs impact extends beyond the investment and into transforming the lives of employees from underserved areas.

[see [www.ceicommunityventures.com](http://www.ceicommunityventures.com)]

### Case Study

#### Pacific Community Ventures

Pacific Community Ventures innovative exit processes and employee on-ramp program help them to optimise impact throughout the investment process.

PCV has pioneered innovative exit planning processes such as 'equity set-asides' for low-income, non-management employees in SMEs within PCVs portfolio. This program builds in a plan to pay employees a cash payout through a wealth sharing plan triggered by an exit sale of a company. Employees thus have an opportunity for asset-building and an incentive for added productivity as they share in the wealth that is created on exit. The equity set-aside is built into the plan and execution of exit strategies where the company is sold to other investors. This extends the impact of their investment to provide economic opportunities for residents of underserved areas.

PCVs Employee Onramp program is designed to provide asset-building and support services to low-income employees of SMEs in the PCV portfolio. The program focusses on helping these employees enter the financial mainstream, build their financial capacity, build assets and access other essential services. This program is delivered via a network of partner organisations and helps to ensure that the PCVs impact extends beyond the investment and into transforming the lives of employees from underserved areas.

[see [www.pacificcommunityventures.org](http://www.pacificcommunityventures.org) and also Caplan et al, 2007]

### Case Study

#### Bridges Ventures

Bridges Ventures structures their investment process in way that optimises both impact and commercial considerations. Impact considerations form the basis of an initial screen what ensures that investments are located in an underserved area according to the Index of Multiple Deprivation (IMD). The investment analysis and due diligence then focusses entirely on a commercial assessment. The investment process includes close engagement with invested SMEs to look for opportunities to enhance social value in addition to building commercial value. Tracking and reporting includes both impact and financial performance over the life of investments.

[see [www.bridgesventures.com](http://www.bridgesventures.com)]

## STRUCTURING INVESTMENT OPPORTUNITIES

In order to achieve scale in Impact Investment there is a need not just to carefully structure the process and the institutions managing the investment, but also to look at how to structure the investment opportunities themselves. This may involve exploring structures that:

- Enable capital and impact **partnerships**, so that different investment stakeholders can contribute different amounts of capital and potentially focus on ensuring that different parts of the process are undertaken with an eye to both impact and return (so, for example, a CDFI may partner with a larger financial institution to supply the capital; and together they may also partner with a philanthropically funded business advisory service that can help to inject management expertise into the invested business);
- Enable **layered** investment structures whereby investors with different objectives come together to generate the intended impact;
- Develop a **portfolio** approach to the investments attracted into and made by the investment vehicle to enable an appropriate balance of risk/impact and risk/financial return across the portfolio.

One of the key challenges of building scale into Impact Investment has been that generating blended value has been seen as requiring a blended investment structure so that all investors share equally in both the impacts and returns. This may work well for some investment propositions which can be structured to generate attractive financial returns with an ancillary benefit of meaningful impact [for example, see the CalPERS California Initiative, [www.calpers.ca.gov](http://www.calpers.ca.gov) which claimed to generate returns of over 22% pa for investors whilst also generating significant economic impacts including over \$15 billion in economic activity in California in 2006 – see Raman, 2008;p.2].

Recent innovations have led to greater differentiation between ‘blended returns’ and ‘layered structures’:

- **Blended returns** mean that everyone receives the same financial return, and that the investors expect to offset the costs of achieving a specified impact within the calculation of the returns;

- **Layered structures** mean that there are potentially differential returns and impact objectives across different types of investors. Impact First Investors may accept a lower financial return or they may accept a greater proportion of the risk if they can drive greater impact, and this in turn may mean that Financial First investors could reduce their risk or achieve more market comparable returns, thus potentially bringing more investors to Impact Investment. *Figure 12* illustrates this.

The layering of capital from investors with different impact and investment priorities is an important structural innovation in Impact Investment, and has the capacity to build both scale and reach of such investments.

The layering approach itself is not new. It has been used in commercial financial transactions to reflect levels of subordination, risk and return within funds and financial transactions for many years. The innovation developing for Impact Investment is to make adjustments to these approaches to reflect differing impact priorities in the ‘classes’ or ‘tranches’ of investment. Thus structures can reflect the differing priorities of those investors who seek impact over financial return (Impact First investors) and those who require a floor under their financial exposure or operate within recognized portfolio parameters and seek to do so in a way which creates social impact (Financial First investors),

A key consideration in the early stages of market development is whether some Impact Investors are prepared to accept lower financial returns in order to facilitate social impact and reduce the financial risk for Financial First investors in order to attract larger pools of capital. If Impact Investment is to grow to scale there is no doubt that these larger pools of capital (from, for example, superannuation funds) are needed. The issue for structures which require some reduction of capital risk to attract the scale of capital needed for Place-based Impact Investment centres on who will ‘go first’ to take the catalytic role to attract others. In other jurisdictions this has been shared by public sector and philanthropic investors [see *Literature Review* for further details].

Finally, lessons from international experience should be carefully considered in the early



Figure 12

Layered Cake Deals as an Impact Investment Structure

See Literature Review [4.3.4] for further details

stages of market development. We would point particularly to two areas that are currently ‘alive’ on both sides of the Atlantic. First are the ongoing discussions and debates centred on the need to balance financial opportunities with social needs

which most often raises the question of whether particular forms of structuring actually require subsidisation in order to generate real social impacts [see *Literature Review*].

Second is the need to think through the practicalities of how both retail and institutional investors can make realistic assessments about financial and impact potentials of Place-based Impact Investment, and whether supply-side intermediation (in the form of financial advice and planning) needs to consider extending their expertise beyond purely financial data into the world of impact assessment (David Carrington, personal communication). In overseas markets, there is a growing realisation that scaling Impact Investment requires attracting the full range of investors – from mainstream, institutional investors, to high-net-worth individuals, and other sophisticated investors, in addition to philanthropic investors. Ensuring an equal focus on supply-side intermediation in the early stages of market development is crucial for building links to this range of investors, which in turn could help to drive both the viability and scalability of Place-based Impact Investment in Australia.

## // STRUCTURE – Key design questions

- Should the design of Place-based Impact Investment focus on debt or equity? What implications does this have for demand and supply-side structuring?
- What implications does the categorisation of Impact Investment as an intermediary market have for the structuring the institutional framework for Place-based Impact Investment? What is the role and place of intermediaries such as CDFIs in potential Place-based Impact Investment initiatives in Australia? What steps could be taken to establish and/or develop existing Australian CDFIs to enact Place-based Impact Investment?
- What impact considerations should be built into the structuring of the investment cycle in Place-based Impact Investment?
- What opportunities can be developed to structure investment opportunities so as to build scale around Place-based Impact Investment? What opportunities are there for capital and impact partnerships? How can layered investment structures facilitate the coming together of investors with different appetites for impact and return? How can the development of a portfolio approach help to establish positive correlations between risk/return and impact?

## PERFORMANCE

Measures the social impact generated through investment in underserved communities to ensure that the purpose of the investment is achieved.

In the development of Place-based Impact Investment, methodologies of financial and impact performance measurement and reporting are key building blocks of any design. Specifically, the measures reported must be capable of being related back to the purpose identified. Further, what is both practical for fund managers and meaningful to investors will reflect the focus and structuring adopted.

Financial reporting is a necessary and important part of any investment fund, and investors expect regular performance reports using standardised measures and benchmarks.

According to many practitioners, investors and academics, impact reporting is now also necessary, particularly as investors in this type of investment are seeking to make a difference through their investment. As with the development of socially responsible and related 'ESG' investment, transparency and veracity will become increasingly important.

Recent international initiatives have begun to develop and share an emerging Impact Investment infrastructure focussed on standards and benchmarks. The development of these initiatives over coming years will enable greater comparisons across Impact Investments and will no doubt create a higher degree of investor understanding and thus confidence in this emerging asset class. *Table 4* outlines the elements of this emerging international Impact Investment infrastructure.

Many Place-based Impact Investment initiatives are now beginning to reference this infrastructure even if they use bespoke measurement and reporting frameworks.

However, there are still a variety of measurement and reporting systems in the marketplace, and some decisions need to be taken in the development of a new initiative, about which ones are most appropriate, practical and least resource intensive.

Investment Infrastructure Elements and Examples	Role in Building and Scaling Impact Investment	Commercial Investment Equivalents
<b>Impact Investment Standards</b> → Impact Reporting and Investment Standards (IRIS)	→ Principle level standards developed to provide a common reporting language for impact-related terms and metrics; → Enabling performance comparisons and benchmarking; → Streamlining and simplifying reporting requirements for companies and investors.	→ Global Investment Performance Standards (GIPS) → International Financial Reporting Standards (IFRS)
<b>Social Value/Impact Measurement Tools</b> → B Impact Rating → SROI → Community Investment Impact System (CIIS)	→ Shared, comparable, verifiable and understood methodologies for analysing data to establish the impact and/or value of an invested company or organisation; → Enables investors, funds and companies to understand and build on their impact.	→ International Accounting Standards that set out not only what is reported, but also how it is measured.
<b>Impact Investment Ratings</b> → Global Impact Investing Ratings System (GIIRS) → Comprehensive Ratings for CDFI Investments (CARS)	→ Independent third-party impact ratings that enable comparisons across both companies and funds; → Social performance metrics and key performance indicators specific for different industries, impact areas and investor preferences; → Benchmarking and analytics for longitudinal comparability between companies and funds.	→ Morningstar Investment Ratings → Standard and Poors (S&P) Credit Risk Ratings
<b>Comprehensive and Searchable Database</b> → Impact Base	→ Searchable online database of Impact Investment opportunities across asset class, geography and other categories; → Opportunities for promoting Impact Investment opportunities	→ Ratings agencies have searchable databases comparing funds across asset class and performance

Table 4

*Elements of Impact Investment Performance Infrastructure*

Source – IRIS [<http://iris.thegiin.org>]; GIIRS [<http://giirs.org>]; Impact Base [[www.impactbase.org](http://www.impactbase.org)]

The process of designing a framework for measuring the impact performance of a Place-based Impact Investment initiative involves answering a number of key questions, as outlined in *figure 13*.

**Elements of Impact Measurement Design**

Any impact performance measurement design begins with an overview of the social objectives that a fund or investor seeks to realise through the investment strategy. In the case of a Place-based Impact Investment fund the social objectives could focus across three areas:

- Increasing flows of investment capital into underserved areas;
- Using investment to build strong and prosperous local economies;
- Increasing the quantum of quality jobs for low-income people residing in the area.

These objectives then shape the nature and the use of impact measures and indicators. In relation to a Place-based Impact Investment fund, these objectives could shape:

- Where the investments are to be focussed (using indicators to screen target areas);
- What social outcomes / impacts the investments seek to deliver (using indicators to track and improve on performance in relation to the social objectives);
- How these outcomes / impacts are reported to investors (using indicators as the basis of reports to investors).

The importance of measurement, then, relates not only to reporting, as is illustrated in *figure 14*.

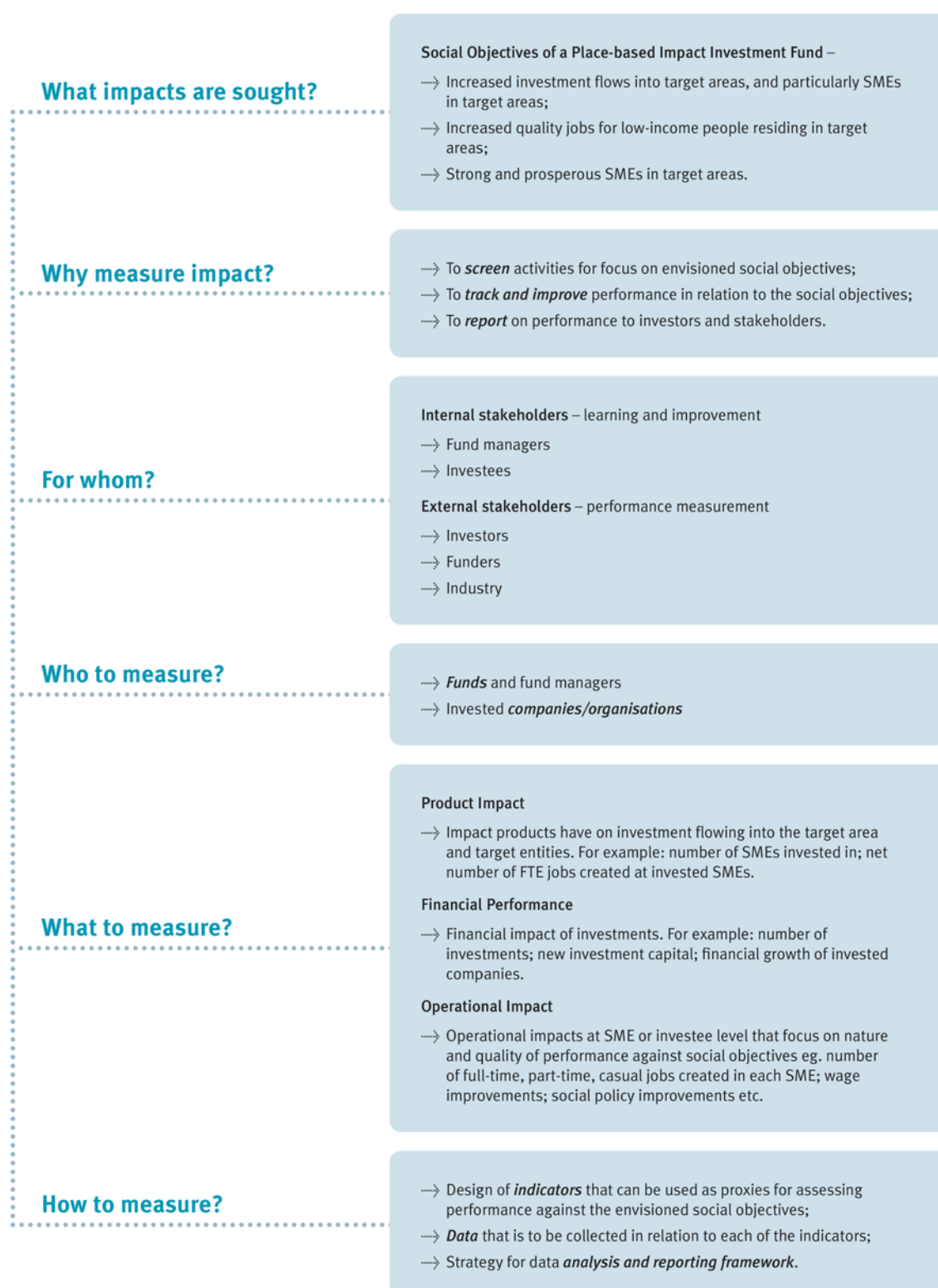


Figure 13

Key elements of an impact measurement framework for a Place-based Impact Investment initiative



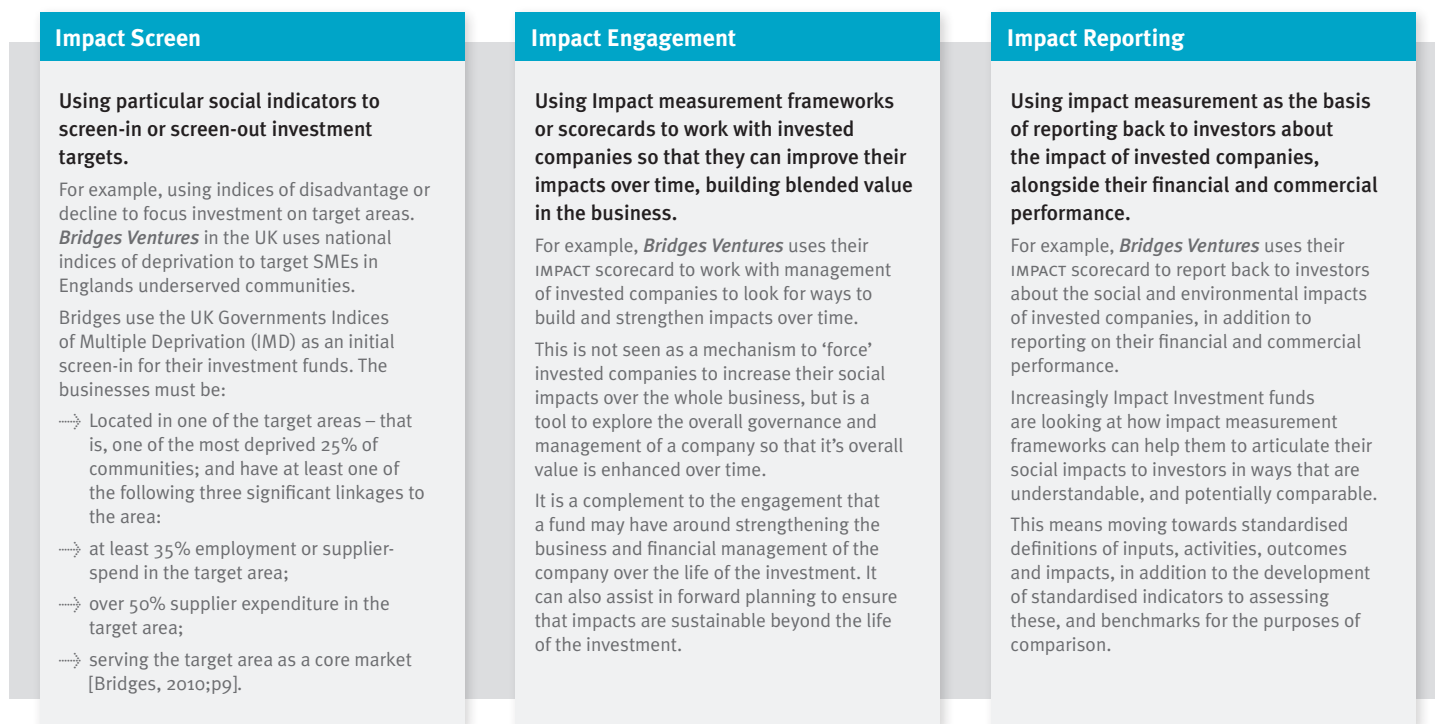


Figure 14

Use of measurement systems for different purposes over the lifetime of an investment

### Standardised and Customised Systems


Some of the metrics used in measurement systems are customised and others are standardised. There are of course advantages to both. Standardised metrics are comparable across different funds, whereas the customised ones are less comparable. Customised metrics differentiate and reflect the unique features and impacts of funds and of particular companies, potentially leading to a more complex and complete impact picture, which standardised metrics may not necessarily allow.

For example, Bridges Ventures in the UK has developed a customised measurement and reporting system that allows them to focus specifically on the social impacts they have set out to achieve. As there are currently no similar funds in the UK there is no real need for the adoption of a standardised system that could be used to compare Bridges to other funds, and it is therefore more important to ensure that the impact expectations of investors are adequately reflected in the measurement and reporting

framework. Bridges is, however, in the process of upgrading their impact measures so that they conform with the standard measures developed in IRIS [see table 4].

In addition, the Bridges IMPACT Scorecard acts as an internal governance tool so that impacts in each investment can be heightened over time and SMEs can check their impact progress against other SMEs in the Bridges portfolio. Thus, as Bridges Ventures identifies, the Scorecard has two functions, in that it: articulates and measures performance for investors; and it enables Bridges to look for opportunities to add value over the life of the investment – whether that be social value or commercial value. In other words, Bridges:

*‘works with the management of the investee companies to identify additional ‘win-win’ opportunities that can benefit the community, employees or the environment as well as the business, and highlight any governance issues’* [2010;p7].



### Product, financial and operational assessments

In the context of a Place-based Impact Investment initiative, the impact measurement is focussed on the benefits that flow from where and how the investment capital is placed. This means that the source of the impact is both the entity that attracts, holds and invests the capital (ie. the institution/fund manager), and the entity in which the capital is invested (the invested company or organisation, which in this case is the SME in which the investment is made).

So an investor interested in tracking the impact of their investment would be interested in a **product assessment** (which outlined the fund manager and their products, services, governance and management); a **financial assessment** of both the fund and the invested companies or organisations; and an **operational assessment** (focussed on tracking the impacts that flow from the operations of the invested companies). The impact metrics may be tailored to some of the specific activities of particular companies, but they may also include generalised metrics tracking a company's performance in relation to the target area.

Therefore, the design of an impact framework is more complex than looking only at relatively simple measures of, for example, how many

jobs have been created in a target area post investment or how much money was invested in a particular target area. Impact measures should certainly seek to explore these figures, but look also at, indicators of quality and sustainability such as who was actually employed (ie. are the employees residents of the target area); and what the broader economic impacts of the invested companies were post investment (eg. whether their suppliers and customers are local, what their spend in the target area was and other multiplier effects).

In the Australian context, some of the indicators used in impact measuring frameworks in the US and UK are not relevant due to differing labour standards and guaranteed labour conditions (such as compulsory superannuation), and other indicators may more appropriately reflect impacts relevant to local contexts. An impact scorecard which references IRIS standards and considers the GIIRS ratings system in its design, but targets the particular impacts sought, and reflects other aspects of the Australian market is proposed in the context of the strategies outlined in the next section. A table summarising the indicators proposed in this scorecard is included in *appendix two*.



## // PERFORMANCE — Key design questions

- What are the key impacts sought through the particular Place-based Impact Investment initiative and how will we know if they have been achieved?
- How can impact be optimised and value added over the life of the investment?  
How can indicators and data be used to assist in this process?
- What indicators will elicit information about the product and operational impacts of Place-based Impact Investment?
- What data should be collected using these indicators?
- How should impact data be presented and reported to investors and stakeholders?
- What links could and should be made between any emerging Place-based Impact Investment initiatives and the developing impact performance infrastructure (eg. IRIS, GIIN)?
- How appropriate are the global ratings and assessment systems being developed (ie. GIIN) to Place-based Impact Investment in Australia?
- What are the benefits and limitations of bespoke reporting frameworks in the Australian context?

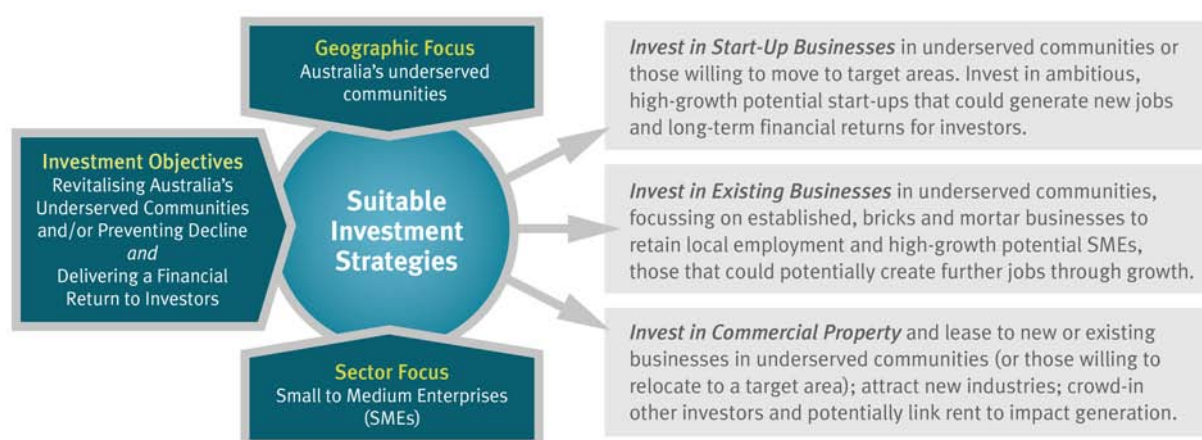
# STRATEGIES

## for Implementing Place-based Impact Investment in Australia

While there are potentially many different strategies open to Place-based Impact Investment, based on the elements outlined here and in the *Literature Review*, this report proposes three options that could successfully meet impact objectives of revitalising local economies; and retaining and creating quality jobs in Australia's underserved communities [see *figure 15*].

Each of these options has potential to form the basis of a Place-based Impact Investment strategy in the Australian context. Each example also includes international case studies of relevance for the approach proposed as a concrete illustration. It should be noted that these options have been suggested following a rigorous examination of the Australian context [see the *Literature Review*].

In other contexts, such as the US, Place-based Impact Investment has focussed on different strategies (based, for example, largely in housing real estate and commercial property) because there are a range of policies in place that incentivise this form of investment (for example the New Markets Tax Credit and Low Income Housing Tax Credit schemes) [Ben Thornley, personal communication]. As these incentives are not in place in the Australian context, and as the nature of underserved communities and therefore the investment objectives are quite different, Place-based Impact Investment needs to build on those foci and strategies that are most likely to be successful here. We hope an exploration of the following strategies will open broader dialogue and debate in Australia about other potential options for Place-based Impact Investment in this context.



*Figure 15*  
Key investment strategies for Place-based Impact Investment focussed on SMEs

# STRATEGY ONE

## Investing in Start-Up Businesses in Underserved Communities

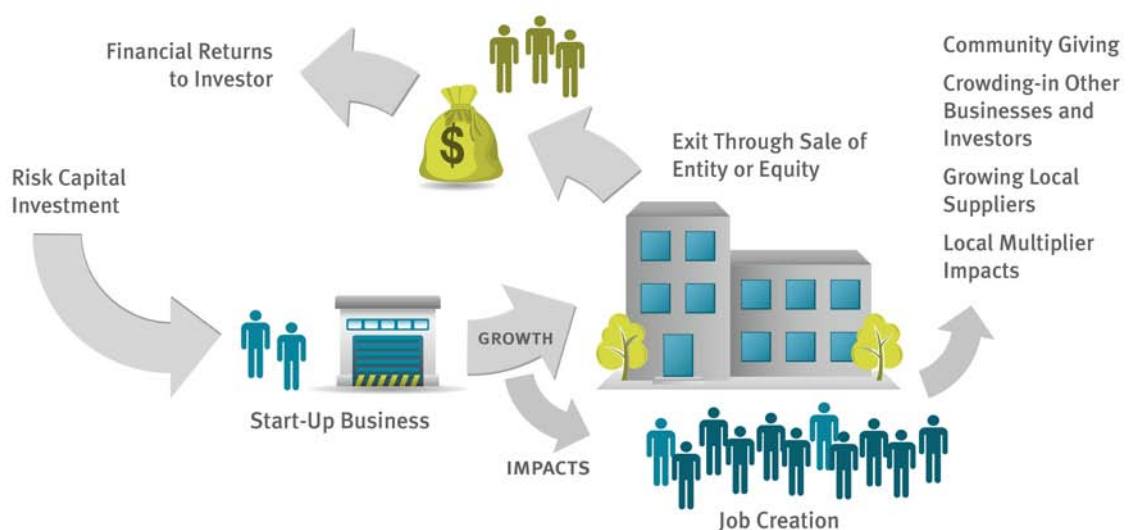
This strategy focuses on the role risk capital can play in capitalising start-up businesses with high-growth potential, with the intention that these businesses stimulate local economic development and create new jobs in underserved areas. Investing in start-ups may also attract new industries to target areas, increasing the diversity of industries and therefore the diversity of jobs, and contributing to the growth of the local economy. Financial returns would be generated out of long-term growth of the enterprise, and either its eventual sale or the sale of the shares of the investor. *Figure 16* and *table 5* provide an overview of this strategy.

Dimensions of Impact Investment	Potential for this Strategy
Overview	→ Investment in start-up businesses located in or willing to move to underserved areas. The strategy is focussed on the provision of risk capital.
Structure Options	→ Loan fund → Venture fund
Potential for Impacts	→ Could attract new industries to underserved areas; → May lead to significant new employment opportunities
Potential for Returns	→ Potential for high returns but risk profile could negate this potential
Potential Risks	→ Very high risk strategy both from impact and returns perspective → Geographic focus could exacerbate risk levels
Exit Options	→ Sale of business, ESOPs, employee benefit provisions. Impact risks of exits need to be planned for.

*Table 5*

*Snapshot of Strategy One*

### INVESTING IN START-UP BUSINESSES IN TARGET AREAS



*Figure 16*

*Investing in Start-Up Businesses as a Place-based Impact Investment Approach*

Potential <i>benefits</i> from a Financial Return perspective	Potential <i>benefits</i> from an Impact perspective
<ul style="list-style-type: none"> <li>→ Similar to traditional venture capital potential for strong, above-market returns over time.</li> </ul>	<ul style="list-style-type: none"> <li>→ Could attract new industry sectors to an area – especially new economy businesses or niche businesses;</li> <li>→ Venture Capital investment often yields the greatest employment shifts as start-ups by their very nature start with few employees and then grow from this base (though there are questions about quality and longevity of jobs);</li> <li>→ Successful start-ups often attract in other start-ups or businesses, opening more opportunities for employment;</li> <li>→ Potential to develop local supplier base and grow other companies in the area.</li> </ul>
Potential <i>risks</i> from a Financial Return perspective	Potential <i>risks</i> from an Impact perspective
<ul style="list-style-type: none"> <li>→ Similar risks to traditional venture capital with some added place-based risks;</li> <li>→ High risk investment strategy and risk could be exacerbated when geographical screens are added to the mix;</li> <li>→ May not be a large enough pool of high growth enterprise possibilities; enough diversity of industry types; in the area or strong enough pool of management skill in the target area to drive the growth and development of start-ups.</li> </ul>	<ul style="list-style-type: none"> <li>→ Best financial returns may not come from companies that have the best potential for creating employment of people from the target area;</li> <li>→ Growth companies may attract and seek to employ people from more skilled areas – may result in in-migration of employees rather than drawing from local base;</li> <li>→ May be a skill differential if growth companies are in new economy industries that may make it harder to draw from local employment base.</li> </ul>

Table 6

*Key Risks and Benefits of Place-based Impact Investment in Start-Up Businesses across Financial Returns and Impacts*

There are two main options for structuring such initiatives:

- **Loan fund** – that lends start-up capital to entrepreneurs in underserved areas;
- **Venture capital fund** – that invests in start-up businesses in underserved areas. This could be through equity or a mixture of equity and patient debt capital.

Loan funds that target start-up businesses are considered very high-risk and such loans are usually unsecured because of a lack of collateral. Such a strategy for Place-based Impact Investment initiative could consider mechanisms for reducing the risk, such as:

- seeking philanthropic or grant capital funded guarantees that could help bring other investors to the table;
- using a combination of equity and patient capital, with tools such as subordinated or convertible debt (debentures or bonds)

or royalties to structure the investment so that investors can recoup different kinds of returns (capital gains and yield) over the life of the investment, thereby reducing some of the risk.

Like its parallels in early stage investments in commercial and research sectors, this is a higher-risk strategy. In addition to the considerations of risk and return, the effect on likely social impacts intended for the fund also needs to be taken into consideration. *Table 6* outlines the potential benefits and risks (from both a financial return and impact perspective) of investing in start-up businesses as an approach to Place-based Impact Investment.

Further, it needs to be recognised that only a small proportion of start-up businesses have real potential to generate jobs and deliver financial returns. Therefore, if this was to be



Employment	Governance	Local Economic Development
<ul style="list-style-type: none"> <li>→ Increased employment of people residing in target area, in sustainable, quality jobs</li> <li>→ Increased wages for low-income people residing in target area</li> <li>→ Increased employee training and skill development for people residing in target areas</li> </ul>	<ul style="list-style-type: none"> <li>→ Strengthened early stage business governance in invested companies in target area</li> <li>→ Increased number of locally focussed businesses with strong ethical and social responsibilities</li> </ul>	<ul style="list-style-type: none"> <li>→ Increased range of businesses in local area, and therefore increase economic opportunities</li> <li>→ Increased occupation rates of business premises in local area</li> <li>→ Increased supplier spend in local area (mainstream and social enterprise spend)</li> <li>→ Increased local market development (increased local customer base)</li> </ul>

*Table 7**Potential Elements for an Impact Scorecard Focussed on Strategy One*

developed as a Place-based Impact Investment strategy it would need to be built on a firm understanding of the kinds of businesses that could create jobs and deliver returns in the target areas. Given its potential to generate new jobs and attract new industries, however, this strategy could represent an important strategy for restorative approaches to addressing decline in underserved communities. This potential economic contribution of Early Stage enterprises has been recognised in Australia through initiatives such as the Early Stage Venture Capital Limited Partnerships (ESVCLP) initiative of the Federal Government [see [www.ausindustry.gov.au](http://www.ausindustry.gov.au)]. Using this strategy for Place-based Impact Investment could build on such initiatives to incorporate a ‘place’ focus.

Finally, such an approach could benefit from some analysis and economic modeling that links employment projection data (eg. DEWR Industry Employment Projections), with SME entry and exit data [the ABS collects this data, see ABS, 2011], and some analysis of SME growth across the key industry areas.

Despite the high risks from both a financial return and impact perspective, investing in start-up businesses has been a focus or a part of a number of Place-based Impact Investment initiatives internationally. However, it should also be noted that a number of funds began with a strategic intent to invest in start-ups (using both debt and equity mechanisms), but then with experience realised that there are risks both from a financial and an impact perspective, particularly if the goal is the generation of quality, sustainable jobs.

The case studies on the following pages include a number of funds that include investment in start-ups and early stage businesses as part of a broader investment process, thereby spreading the risks across a wider portfolio. This could provide a way forward if this approach was to be used in an Australian Place-based Impact Investment initiative.

### Impact

An impact scorecard for this strategy could include the social impacts outlined in *table 7*. More detailed indicators and definitions are included in *appendix two*.

## CASE STUDY

Community Development Venture Capital (CDVC) organisations and funds in the US have provided venture capital to start-ups in underserved areas.

**Coastal Enterprises Inc (CEI)**, established almost 30 years ago to address issues in underserved communities in Maine, US, is one such organisation. Through their two subsidiaries, *CEI Ventures, Inc.* and *CEI Community Ventures, Inc.* they operate Venture Capital (VC) funds focussed on growth-oriented businesses in Maine.

The investments are relatively small compared with mainstream VC, ranging from \$100,000 to \$500,000, but up to \$5 million is possible (larger sums are with partner funds). CEI believes that 'there are compelling investment opportunities in a range of markets underserved by the financing community. Through investing in these companies, we create quality employment opportunities, especially for people with low to moderate incomes, promote progressive management practices, support socially beneficial products and services, enrich distressed communities, and foster environmental sustainability' [[www.ceimaine.org](http://www.ceimaine.org)].

They have learnt over the course of their work that finance alone will not generate impact – therefore alongside their funds they have developed technical assistance and support services in their main organisation (CEI).

### Coastal Enterprises Inc (CEI)

<b>FOCUS</b>	<p><b>Geographic Focus</b> – Rural regions of Maine, US, traditionally underserved by mainstream financial institutions;</p> <p><b>Sector Focus</b> – Businesses whose sizes vary from one employee to 500, in stages from start-up to mature. Targeted sectors have included: value-added fisheries, farms and forest projects; microenterprise development; targeted job creation.</p>
<b>STRATEGY</b>	<p>CEI engages a wholistic approach to building assets, linking business financing to job creation, entrepreneurship, sustainable development, policy advocacy and research.</p> <p>CEI lends and invests money and provides business counseling services to companies in Maine and New England. CEI also has a policy arm.</p>
<b>FUNDS</b>	CEI subsidiaries manage funds associated with the New Markets Tax Credit program and a number of Venture Funds (three closed fund across the subsidiaries), totaling around US\$35 million.
<b>IMPACT</b>	<p>All financing activity is measured by the social impact of each project. Specific impacts include – Businesses/people counseled: 33,572; Full-time jobs at loan closing: 25,235.</p>
<b>RETURNS</b>	Venture fund returns are on track to be consistent with average CDVC returns (10–15% IRR). Investors under the NMTC program expect 'attractive rates of return' though it is not clear from CEI's information exactly what these returns are. Historically the venture funds have generated returns of between 11% and 20% [Markley et al, 2001].

## STRATEGY TWO

### Investing in Established High Growth Potential Businesses in Underserved Communities

This strategy focusses on how investment could grow and strengthen existing, established businesses in underserved communities, retaining existing jobs, stimulating a dynamic local economy and generating new, quality jobs. Such a strategy could focus on helping businesses in underserved communities access growth capital, growth-oriented working capital and asset development capital. Each of these kinds of capital can have an impact on a company's capacity to take on and retain employees, particularly in times of economic constraint [see for example, CPA, 2010].

Dimensions of Impact Investment	Potential for this Strategy
<b>Overview</b>	→ Investment in established businesses in underserved communities focussed on growth capital, growth-oriented working capital, and asset development capital.
<b>Structure Options</b>	→ Loan fund → Growth (equity) fund
<b>Potential for Impacts</b>	→ Potential to plug SME capital supply gap → High potential to grow new quality jobs and retain existing jobs in area
<b>Potential for Returns</b>	→ Good potential for market comparable returns over the long-term when risk is accounted for
<b>Potential Risks</b>	→ High risk strategy but risk mitigation structures can help to reduce risk → Exits for equity investments present biggest impact risks
<b>Exit Options</b>	→ Sale of businesses, ESOPs, employee benefit provisions. Impact risks of exits need to be planned for.

*Table 8*  
Snapshot of Strategy Two



*Figure 17*  
Investing in Established Businesses as a Place-based Impact Investment Approach

Potential <i>benefits</i> from a Financial Return perspective	Potential <i>benefits</i> from an Impact perspective
<ul style="list-style-type: none"> <li>→ Mix of equity, near-equity, debt and property-backed investments in SMEs could have long-term growth plus cash flow benefits;</li> <li>→ Potential for substantial returns over time;</li> <li>→ Hybrid structuring may include cash-flow returns from very early into the investment. Investors can therefore benefit from yield &amp; growth returns.</li> </ul>	<ul style="list-style-type: none"> <li>→ Strengthening &amp; growing existing businesses in the area could lead to increase in employment opportunities for people from target areas;</li> <li>→ Opportunities for strengthening local supply chains – benefits could flow on to other companies in the area, which in turn could generate further employment opportunities;</li> <li>→ Potential to crowd-in other businesses and investments;</li> <li>→ Multiplier effects of stronger local business;</li> <li>→ Development of strong management practices in the companies could build long term employment security for people from target area;</li> <li>→ Including access to debt capital &amp; hybrid strategies for existing businesses in the target area may help businesses facing cashflow issues to access finance &amp; therefore keep staff during times where credit is difficult to access [see CPA, 2010];</li> <li>→ Incorporating opportunities for employee ownership and 'equity set-asides' has the potential to build the asset base of low-income employees from underserved communities.</li> </ul>
Potential <i>risks</i> from a Financial Return perspective	Potential <i>risks</i> from an Impact perspective
<ul style="list-style-type: none"> <li>→ Higher risk investment strategy – and risk may be exacerbated through the geographical screen;</li> <li>→ The pool of businesses with high growth potential may not be sufficiently large enough across target areas, especially given the concentration of vulnerable and old economy industries in these regions, making equity investments a difficult proposition;</li> <li>→ Debt capital for SMEs is often restricted to bank loans, it is unclear whether structuring hybrid options could be cost effective in the Australian SME context;</li> <li>→ Differential risk according to type, structure and security;</li> <li>→ May be long-term investment so risk-return structure is important, as are exit strategies.</li> </ul>	<ul style="list-style-type: none"> <li>→ For equity investments the greatest risk is what happens at &amp; post exit in relation to the local impacts. There is a risk of undoing impacts, or worsening original impact baselines, especially if the company is restructured, broken up or moved out of the area. Use of hybrid strategies and quasi-equity could mitigate some of these impact risks;</li> <li>→ Type of company/business that has high growth potential may not have the greatest potential for employment opportunities of people from target area;</li> <li>→ Increasing social impacts may require some kind of subsidisation of returns, which need to be drawn from somewhere.</li> </ul>

Table 9

*Key Risks and Benefits of Place-based Impact Investment in Established Businesses across Financial Returns and Impacts*

While the process looks similar to that of risk capital, growth strategies have a different risk profile (ie. lower risk), and the impacts are potentially more stable over time, as established companies tend to offer more secure jobs of a higher quality (eg. better wages and conditions), and are less likely to fail than start-ups. *Table 8* and *figure 17* provide an overview of this strategy.

There are two options for structuring initiatives under this second strategy:

- **Loan fund** – an alternative lending facility for established businesses seeking growth oriented debt capital but unable to obtain this from mainstream financial institutions.
- **Growth fund** – focussed on equity, mezzanine and/or quasi equity capital for established

Employment	Governance	Local Economic Development	Ownership
<ul style="list-style-type: none"> <li>→ Increased employment of people residing in target area, in sustainable, quality jobs</li> <li>→ Increased wages for low-income people residing in target area</li> <li>→ Increased employee training and skill development for people residing in target areas</li> <li>→ Increased asset development of low-income employees in target area</li> </ul>	<ul style="list-style-type: none"> <li>→ Strengthened business governance in invested companies in target area</li> <li>→ Strengthening of locally-focussed businesses with strong ethical and social responsibilities</li> </ul>	<ul style="list-style-type: none"> <li>→ Increased growth of businesses in local area, and therefore increase economic opportunities</li> <li>→ Increased supplier spend in local area (mainstream and social enterprise spend)</li> <li>→ Increased local market development (increased local customer base)</li> <li>→ Increased value of dollars gifted in the local community</li> </ul>	<ul style="list-style-type: none"> <li>→ Policies and practices in place for employee asset-building</li> <li>→ Total dollar amount of benefits paid to employees through equity set-asides when a business is sold</li> <li>→ Policies and practices in place for enabling Employee Share Ownership Plans</li> <li>→ Total value of shares owned by employees</li> </ul>

Table 10

Potential Elements for an Impact Scorecard Focussed on Strategy Two

businesses with the intention of capitalising growth and development.

This strategy requires careful thought to both supply-side and demand-side factors if it is to be successful. As explored in the previous section, capital access is not the only 'gap' that affects SMEs growth and development. As a number of the case studies highlight, access to technical assistance, capacity-building, mentoring, access to networks and business advice can be just as important in ensuring that businesses have an opportunity to grow and develop.

A key part of this strategy, then, is to structure in capacity-building for SMEs such that the probability of generating impacts and returns is optimised and the risks of investment are reduced.

This strategy could have both preventative and restorative impacts in declining communities. It has been used with particular impact as a restorative measure internationally.

Table 9 outlines the potential benefits and risks (from both a financial return and impact perspective) of investing in established businesses as an approach to Place-based Impact Investment.

### Impact

An impact scorecard for this strategy could include the social impacts outlined in table 10. More detailed indicators and definitions are included in appendix two.

## CASE STUDY

**Seedco Financial** is a not-for-profit CDFI (wholly owned subsidiary of Seedco) that has over \$70 million in assets under management. Seedco Financial operates a loan fund that lends to small businesses in underserved areas in Alabama, New York and Louisiana. They lend to established SMEs in all sectors that are either located in an underserved area or predominantly employ people who lived in underserved areas. Through their loans in 2010 they helped to create around 600 new jobs and retain 250 existing jobs. Seedco also offers business services and technical assistance to SMEs in these areas, including legal, IT, recruitment and financing assistance. In 2010 they supported over 2000 businesses with these services. They regularly report on impact metrics, including: 1) jobs created; 2) jobs retained; 3) % of clients operating within low-to moderate income communities; 4) % of clients who are minority- and women-owned business enterprises (MWBES).

Investors include banks and financial institutions, foundations and government. They are investors who are interested and involved in creating opportunities in underserved communities, so are predominately Impact-First investors.

[see *Seedco Financial*, [www.seedcofinancial.org](http://www.seedcofinancial.org)].

Seedco Financial has engaged in a number of partnerships to increase the reach and scope of its lending in underserved areas:

The Growth Opportunity Loans & Services (GOLS) Initiative is a unique financing and business assistance program developed by Seedco Financial. The GOLS Initiative is part of Goldman Sachs' 10,000 Small Businesses program, a \$500 million initiative designed to unlock the growth and job-creation potential of 10,000 small businesses across the United States. The GOLS Initiative provides affordable financing, coupled with strategic mentoring and business support, to select high-growth-potential small businesses in the five boroughs of New York City. These loans are available in amounts ranging from \$250,000 to \$750,000.

[see [www.seedcofinancial.org/GOLS](http://www.seedcofinancial.org/GOLS)]

A partnership with Biz2Credit, a for-profit company that links SMEs with lenders, aims to extend the reach of Seedco Financial's lending products in underserved areas. Through the partnership, Seedco Financial will start to receive and process small business loan applications from qualified members of Biz2Credit's network of over 25,000 small companies.

[see [www.biz2credit.com/seedco-financial-and-biz2credit-announce-partnership](http://www.biz2credit.com/seedco-financial-and-biz2credit-announce-partnership)]

### Loan Features for Seedco Financial

Loan Feature	Financial Information
Loan Type & Term	Term loans for between 6 and 60 months
Loan Amount	\$50,000 to \$750,000
Interest Rate	8–10% p.a.
Loan Purpose	Equipment financing, inventory financing, leasehold improvements, working capital
Social Screen	Located in low- or moderate income and/or underserved communities, and/or majority-owned by women, members of racial/ethnic minorities, or other disadvantaged groups, and/or employ majority of workers from low- or moderate income communities
Operational Eligibility	SME has been in operation for at least one year and had minimum \$200,000 revenue in last financial year; 100 or fewer staff.
Security	Personal guarantee from principals owning 20% or more of company.



## CASE STUDY

**Pacific Community Ventures Investment Partners I, II and III** are venture funds managed by *Pacific Community Ventures (PCV)*. These funds attract institutional investment that is invested in mid to later-stage businesses with growth potential, the capacity to create jobs and contribute to economic growth in California, US.

The focus is on non-technology businesses, with turnovers of at least \$5 million and up to \$50 million, employing between 10 and 100 people from low-income communities. Although it is a generalist fund, PCV places special emphasis on small, high-growth Californian businesses in – specialty food products; ethnic products and services; health and wellness; custom, low-capital intensity manufacturing; environmentally-friendly focussed products.

They currently have more than \$60 million under management, and the latest fund (Fund III) closed at \$40.5 million in early 2008. Their second fund (PCV Investment Partners II) had a realised gross IRR of 28.3% (total IIR 6%; projected 18.5%). Their investments focus on growth equity, management led buy-outs, liquidity for family-owned or closely-held companies and recapitalisations/restructurings to facilitate growth.

Their investment strategy is supported by other programs including:

- a business advisory service that offers advice to SMEs who may not be investment-ready;
- an employee asset support program that offers employees in the PCV portfolio the opportunity to improve finances, build assets and plan for their futures.

PCV has also developed some very innovative exit planning processes, including the negotiation of equity set-asides which ensure that on exit employees 'are able to share in the financial upside they help to create'. As up to 2/3 of employees of portfolio companies reside in underserved communities this represents another significant social impact of the investment strategy, as it provides an asset-building opportunity for employees. Further, it positions employees as co-producers of the success of the investment process.

Early in its development PCV also invested in early-stage and smaller businesses, but concluded that this was too risky both from an investment and an impact perspective.

*[see Pacific Community Ventures LLC – [www.pcvfund.com](http://www.pcvfund.com) and Caplan et al, 2007].*

### Pacific Community Ventures

<b>FOCUS</b>	<b>Geographic Focus</b> – Underserved communities across California, US; <b>Sector Focus</b> – High growth potential SMEs.
<b>STRATEGY</b>	Growth funds directed at established, mid-to-late stage high-growth potential SMEs in brick and mortar industries (non-technology) with turnovers between \$5 million and \$50 million, employing between 10 and 100 people. Strategy includes business advising model for invested businesses and others who are not yet investment-ready.
<b>FUNDS</b>	Three funds totalling US\$60 million, investments being made out of PCV LLC III, a US\$40.5 million fund that closed in early 2008.
<b>IMPACT</b>	In 2010 PCV invested in 10 companies, who together employ 3000 people, 2/3 of whom reside in underserved areas. Over 12 years created 5000+ jobs in California.
<b>RETURNS</b>	PCVs second fund – realised IRR of 28.3% (total IRR 6%; projected 18.5%).

“

*'The first Fund tried to have too much social impact. To be sustainable, PCV needed to go a little bit upstream to companies that had already survived early growing pains and were closer to an exit strategy but still had the same low-income social impact'.*

*PCV Investor, in Caplan et al, 2007;p.11*

”

## CASE STUDY

**Bridges Ventures Community Development Venture Funds**, in the UK was founded in 2002, Bridges is a private investment company that is majority owned and managed by its executive directors and the Bridges Charitable Trust.

They are currently managing two venture funds investing in businesses in sustainable sectors and/or that are located in the most deprived 25% of the UK, and that can deliver social impacts and financial returns. They have £115 million invested in these funds. The Venture funds invest in early stage, later stage and property backed businesses using venture capital, private equity and near equity instruments.

Their investors are institutional, including financial institutions, pension funds, high-net-worth individuals, trusts and foundations. They use an initial social screen and then strictly commercial criteria to select amongst companies that pass the social screen. They then work with the companies to increase their value and improve social impact and they report on social, environmental, financial and commercial performance.

32 of the 34 investments in the Venture Funds are in the most deprived 25% of UK, and over 60% in most deprived 10% of UK. Companies in which an investment has been made have employed over 1370 people, 40% of whom live in target areas.

Financial results to date include exit returns between 29–165% Internal Rate of Return (IRR) and from 2x to 22x money multiples. Six successful exits have been achieved in Fund I with realised gains of £12.7 million. Fund II is three years into its investment period and 46% of the fund is invested.

[see [www.bridgesventres.com](http://www.bridgesventres.com), also see Bridges and Parthenon, [2010]].

## Bridges Ventures

<b>FOCUS</b>	'Bridges Ventures is a private sector, mission-driven investment company that specialises in funds that can deliver financial returns and make a positive social or environmental impact'
<b>STRATEGY</b>	Three-stage process to target, maximise and report on social impact – <b>Social Screen</b> to focus investments in target areas; <b>Engagement</b> to add social and financial value; <b>Tracking and Reporting</b> financial and impact performance. Bridges works with its portfolio companies to optimise their environmental, social and governance (ESG) impacts, identifying risks as well as opportunities for additional value creation. Bridges believes that this improves social and environmental performance in ways that also improve commercial performance.
<b>FUNDS</b>	<i>BridgesVenture Fund I</i> – £40 million (2002) <i>BridgesVenture Fund II</i> – £75 million (2007) <i>Total funds under management</i> (including property and SE funds) – £187 million
<b>IMPACT</b>	32 of the 34 investments from Venture Funds in most deprived 25% of UK, & over 60% in most deprived 10% of the UK. Companies have employed over 1370 people, 40% of whom live in the targeted areas. 4.1x multiplier – £4.10 of additional spending in target areas for each £1 invested. Each £1 invested leverages additional £2.10 of external investment.
<b>RETURNS</b>	Financial results to end March 2010: Investments in 34 companies totalling £64 million. Six successful exits achieved. <i>Fund I</i> – Realised gains of £12.7 million from six successful exits, including one partial exit. <i>Fund II</i> – Three years into its investment period and 46% invested. <i>Exit returns to date</i> – ranging from 29-165% IRR and from 2x to 22x money multiples.



'Budget cuts and weak growth are disproportionately impacting deprived areas. But the creative investor can tap into strong opportunities by looking for sources of strength in these areas – whether that is in innovative uses for distressed property, in creating value-for-money propositions or in accessing a committed workforce. In turn, investing in these areas creates a multiplier effect, driving additional spending and wealth creation'.

Michele Giddens, Bridges Executive Director, 2011



## STRATEGY THREE

### Investing in Commercial Property in Underserved Communities

Investing in commercial property in underserved areas represents an approach to Place-based Impact Investment if the purpose of the investment is focussed on: providing leasable premises to established businesses or attracting new businesses; establishing an investment presence in underserved areas to crowd in other investors; and potentially linking some returns to new employment impacts. Such investment could result in yield and growth returns for investors and given there is renewed interest in outer suburbs and regional commercial property investment in Australia [see for example, Lomas, 2011] such an approach may be attractive to investors. Table 11 and figure 18 summarise the approach.

Dimensions of Impact Investment	Potential for this Strategy
Overview	→ Investment in commercial property in underserved areas in order to establish an investment presence in the community
Structure Options	→ Property Trust → Property Loan Fund
Potential for Impacts	→ Could attract and crowd-in new industry and new investment → Could link employment impacts to rent reductions
Potential for Returns	→ High potential for market comparable returns depending on the property market
Potential Risks	→ Harder to tie impacts directly to investment. → Property prices in area may not grow over time therefore capital gains may not be realised
Exit Options	→ Planning should include options for business accommodation at exit to avoid losing the business to the locality

Table 11

Snapshot of Strategy Three

#### COMMERCIAL PROPERTY INVESTMENT IN TARGET AREAS

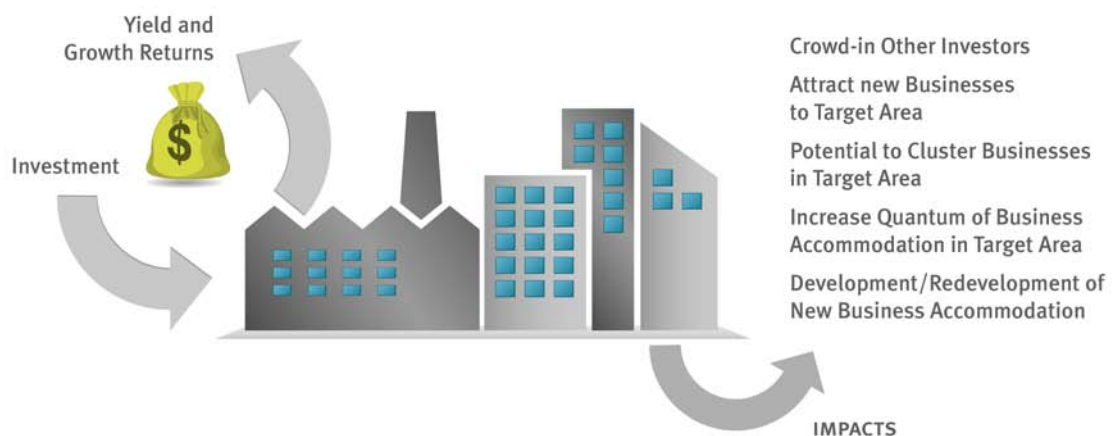


Figure 18

A Commercial Property approach in Place-based Impact Investment

Potential <i>benefits</i> from a Financial Return perspective	Potential <i>benefits</i> from an Impact perspective
<ul style="list-style-type: none"> <li>→ Can provide both cash-flow (from rent) and capital gains (from eventual sale) for investors;</li> <li>→ If the property is in or near a revitalisation area or one that is likely to be a designated revitalisation zone within the investment period, there could be significant capital gain over time;</li> <li>→ If the property is in an area that could attract new industry, this has potential for higher cash-flow as vacancy rates in the area decrease and rental prices increase.</li> </ul>	<ul style="list-style-type: none"> <li>→ Functional, affordable and attractive property that is close to transport corridors could attract new industry to the area, leading to increased potential for local job opportunities;</li> <li>→ Investor interest in an area, and capital expenditure to improve buildings, can crowd in other investors, leading to further potential job opportunities;</li> <li>→ Possibilities exist for increasing social impact through rent reductions per new local job created – may reduce yield but could be attractive for new industries and companies, and could enhance impact, thereby making it attractive for Impact First Investors.</li> </ul>
Potential <i>risks</i> from a Financial Return perspective	Potential <i>risks</i> from an Impact perspective
<ul style="list-style-type: none"> <li>→ Locality may not experience growth in property prices over time;</li> <li>→ Vacancy rates in the area may rise, therefore reducing yield.</li> </ul>	<ul style="list-style-type: none"> <li>→ Properties in the area become unaffordable for existing businesses, thereby squeezing out existing employers because of increased rent;</li> <li>→ The link between property purchase and generating job opportunities does not materialise so that despite financial returns there is no discernible impact.</li> </ul>

Table 12

*Key Risks and Benefits of Place-based Impact Investment in Commercial Property across Financial Returns and Impacts*







Property could be the focus of an approach to Place-based Impact Investment, or property could be linked to other approaches and strategies (for example, property-backed equity investments in established SMEs). Such a strategy could be particularly effective in a preventative purpose for Place-based Impact Investment, where investment was aimed at preventing economic and social decline in an area. Such a strategy could be structured in two different ways:

- **Property Fund or Trust** – purchasing property in underserved areas within a trust and leasing it back to businesses for both capital gains and yield returns;
- **Property Loan Fund** – lending money to businesses or not-for-profit organisations for the purposes of property acquisition or development in underserved communities.

Both these structures have some history in Australian Impact Investment initiatives, though not using a Place-based approach. Foresters Community Finance has initiated

both a property fund and a loan fund focussed on a sectoral approach, that is, commercial property for Not-for-Profit organisations [see Foresters Social Impact Property Fund No. 1, [www.foresters.org.au](http://www.foresters.org.au)]. Other initiatives for such a strategy have also been recently mooted [see the Cultural Property Trust proposal, [www.newmarketsnewmoney.com.au](http://www.newmarketsnewmoney.com.au), 2011]. Further, such a strategy could focus not only on acquisition but also on development and/or rehabilitation of property in underserved communities. Redevelopment of iconic properties could serve to attract new energy into underserved areas. Some of the case studies below illustrate how this could be undertaken in the context of Place-based Impact Investment.

Like all approaches, a Place-based Impact Investment approach centred on commercial property would need to balance risks and benefits across both financial returns and impacts. An overview of key risks and benefits are outlined in *table 12*.

Design Considerations to optimise <i>social impact</i>		Design Considerations to optimise <i>financial returns</i>
<i>Building impacts in to the process and lifecycle of the investment</i> – so, rental charges could be linked to impact performance indicators. For example, for every new job created the company receives a percentage discount on rent.		<i>Engaging in active asset management across the property portfolio</i> – so that appropriate, long-term tenant SMEs are sourced and retained in the property, and so that both yield and growth returns are enhanced through building maintenance and improvement.
<i>Using impact screens to ensure a focus on properties that have the potential to generate greater impacts</i> – so, larger property purchases could be developed using a hub model, co-locating and clustering a number of SMEs within target areas to leverage their impact in stimulating local economic development; or developing iconic property in the target area to attract SMEs and crowd-in other investors.	  	<i>Longer term investment</i> – so that market volatility effects are smoothed over the life of the investment.
<i>Building development costs into the structure of the investment to enhance a property's capacity to deliver impacts</i> – so, regenerating properties in target areas as leading sustainable buildings, thereby broadening impacts to environmental arenas in addition to potentially attracting clean-tech SMEs, investors interested in environmental and social impacts and stimulating local economic and environmental development.	 	<i>Diversification</i> – ensuring that property is diversified across target areas (ie. Australia-wide) and across properties suitable to different industry sectors.

**Table 13**

Weaving together design considerations for optimising social impact and financial returns

This is an area where it is particularly important to consider how different strategic intentions could have different impact and return outcomes. For example, an opportunistic approach to a property fund, which targets higher returns, assumes greater risk and aims for shorter terms, may not be appropriate because it risks the achievement of impacts. A wholesale core property fund, focussed on long-term, income producing properties in target areas, structured so that investors could periodically exit, buy or redeem shares, may be more appropriate for achieving a

balance of financial return and impact. Such an approach may also support clustering and other impacts with potential to contribute to a more productive economic cycle in place. These aspects of design for a property based fund are outlined in *table 13*.

### Impact

An impact scorecard for this strategy could include the social impacts outlined in *table 14* below. More detailed indicators and definitions are included in *appendix two*.

Employment	Local Economic Development
<p>→ Increased employment of people residing in target area, in sustainable, quality jobs</p>	<p>→ Increased number of businesses in local area, and therefore increase economic opportunities</p> <p>→ Increased occupation rates of business premises in local area</p> <p>→ Increased local asset ownership (for property loan fund)</p> <p>→ Increased investment capital flowing into community (could act as a positive attractor)</p>

**Table 14**

Potential Elements for an Impact Scorecard Focussed on Strategy Three

**Case Study****Seedco**

Seedco is a not-for-Profit organisation, headquartered in New York City, whose focus is on advancing economic opportunity for people, businesses and communities in need.

Seedco promotes community economic development through programs focussed on workforce development and work supports, but also through its subsidiary, Seedco Financial Services, which operates a number of loan funds, including a real estate loan fund for the acquisition, renovation, development and/or redevelopment of real estate in underserved areas. This includes affordable housing, community facilities and commercial, retail and mixed use development.

They believe that ‘the revitalization efforts made through projects such as these can greatly improve living conditions as well as promote increased involvement, opportunity, and a sense of community in underserved neighborhoods’

Their real estate loan sizes range from \$50,000 to \$1.5 million and are available with terms of up to 10 years.

*[see [www.seedcofinancial.org](http://www.seedcofinancial.org)]*

**Case Study****JPMorgan’s Urban Renaissance Property Fund**

JPMorgan’s Urban Renaissance Property Fund, in the US is a for-profit fund that targets impacts that are both social and environmental, through the urban development and redevelopment of market rate, affordable and workforce housing, retail, mixed use development, hospitality and other real estate sectors specifically in what are known as ‘Urban Renaissance Markets’ across the USA.

Effectively, the fund is targeting impacts in urban renewal and green development. The fund has \$175 million of fully subscribed capital [Bridges and Parthenon, 2010], and the expected returns are around 15% net of fees

*[see Bridges and Parthenon, 2010]*

## // STRATEGIES for Implementing Place-based Impact Investment in Australia – Questions

- What potential strategy for Place-based Impact Investment is the ‘best fit’ for the Australian context, considering impact, return, risk and ease of implementation
- What longer-term strategies could be developed in Australia?
- What further information is required in order to model these investment strategies?
- What potential partnerships could be formed around these chosen strategies?
- What practice insights can be gleaned from the various case studies about these strategies? What further modifications could be made to each strategy to suit the Australian context and to optimise impact and returns?
- What steps need to be taken to enact these strategies?



## CASE STUDY

**Chicago Community Loan Fund** provides innovative loans for property development in underserved communities. They focus on challenging and gap-filling lending (including pre-development loans) focussed on high impact projects that will have significant community development impacts for underserved communities. Offering below-market returns, they target their investments at Impact-First investors. The spread between the below-market rate and what CCLF earns on their community investments helps to offset operating costs. Investment terms range from one to fifteen years, and interest is typically paid semiannually. Investments range from a minimum of \$1,500 to \$4 million or more, and nearly half CCLF's investors are individuals and families who want part of their investment portfolio to achieve social impacts in underserved communities.

[see [www.cclfchicago.org](http://www.cclfchicago.org)]

### Chicago Community Loan Fund

<b>FOCUS</b>	Lending for property development and pre-development projects across Chicago and particularly in underserved areas. Focussed on challenging but high-impact projects.
<b>STRATEGY</b>	Lending that fills credit gaps that other lenders can't or won't cover in property projects that have a high social impact. CCLF undertakes full financing for very small projects or gaps in larger projects. In relation to property development, CCLF provides predevelopment loans (for non-profit projects and for-profit SME projects), construction and property rehabilitation loans, with interest rates of between 7–9%.
<b>FUNDS</b>	Loan fund that provides a range of development and pre-development loans. Fund has increased from an initial investment of \$200,000 in 1991 to \$28 million under management currently.
<b>IMPACT</b>	Approximately 1,300 jobs created and over 2.1 million square feet of facility and commercial space that provides job opportunities, goods and services, and social service resources for underserved neighborhoods.
<b>RETURNS</b>	Impact-First investment with below-market return—typically 0 to 3 percent—in exchange for a social dividend.

### Bridges Ventures Sustainable Property Fund

<b>FOCUS</b>	<b>Geographic Focus</b> – property located in underserved areas as defined by the Index of Multiple Deprivation (IMD)
<b>STRATEGY</b>	<b>Sustainable Property Fund</b> – Investment across all property sectors located in regeneration areas/underserved communities. Another aspect of this fund is environmentally sustainable property. <b>CarePlaces Fund</b> – In partnership with a healthcare developer this fund invests in pre-let care home developments (so has a particular sector focus).
<b>FUNDS</b>	<b>Sustainable Property Fund</b> – first close at £28 million <b>CarePlaces Fund</b> – first close at £32 million £12 million of investments in 4 development properties have been made across these two funds to date.
<b>IMPACT</b>	175 jobs supported during the construction phase and 241 jobs supported by development post-construction. At least 70 of these jobs have been created in underserved areas.
<b>RETURNS</b>	No data is currently available on returns.

## CASE STUDY

**Bridges Ventures** (UK) has a property fund that invests in all property sectors that are located in a regeneration area (areas deemed to be in eligible local authority areas according to the Index of Multiple Deprivation (IMD)). Bridges closed its first property fund, raising £28 million (with the use of gearing this meant the fund had access to £50 million). Given that Bridges has invested in regeneration areas for almost a decade in their venture funds (which included property-backed investments) they have developed 'access to a pipeline of opportunities and a strong understanding of the needs of occupiers operating in these locations' which they benefit from in the Property Fund.

[see [www.bridgesventures.com](http://www.bridgesventures.com)]



# Conclusion

This report has provided basic building blocks for encouraging action and opening a wider discussion about the potential and conditions for initiating successful Place-based Impact Investment in Australia.

The development needed to bring Place-based Impact Investment alive in this context should be broad and inclusive, encompassing opinions, expertise and perspectives of people from the investment industry, philanthropists, policy makers, social sector professionals and of course, those who are living and working in communities that have been underserved.

Australia has some unique contextual features that will make any Place-based Impact Investment initiatives here quite different to those that currently exist overseas, particularly in the US and the UK, however there is certainly much to learn from the experiences of Place-based Impact Investment in these contexts.

The Impact Investment field is emerging and growing in Australia and this presents a myriad of opportunities for genuine cross-sector partnerships to explore how Place-based Impact Investment could be enacted here. The contributions of different sectors to Impact Investment have already laid good foundations for continued innovation in this emerging investment asset class.

What evolves here will still require innovation and a grounding in the particular financial, regulatory and social environment that exists in Australia. One of the things that will drive development and learning most effectively is action. We need to build the practice and evidence for what works and demonstrate that approaches combining the rigour of investment with an intentional focus on generating positive social impacts can be effective.

The building blocks for Place-based Impact Investment must start with how investment can drive impact in Australia's most under-served communities. In many ways the details of the investment vehicles and process to be used are the easiest part of enacting Place-based Impact Investment. The challenge and the opportunity lie in answering the questions of how such investment processes can be directed towards helping to resolve some of the most challenging issues facing Australia today. It is these questions that have been opened up in this report. We look forward to continuing the dialogue and seeking answers through action.



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## APPENDIX ONE

Number of SMEs by industry in the  
Priority Employment Areas across  
Australia.



The top three or four industries in most of these areas are manufacturing, construction, retail trade and/or agriculture. This table includes the number of SMEs between \$5 million and \$50 million in these areas if they are one of the top four industries in that region. This provides an indication of the nature and type of industries in the SME sector in underserved areas across Australia.

investable market across Australia's underserved communities further information is needed that could expand the range of underserved areas included as target areas, plus extend the range of industries and SMEs that are included as potential investment targets.

There are limitations to these figures. First, they only focus on the top four industries in identified PEA regions. This does not provide an overview of the full potential of SMEs in those areas in terms of investment. Second, it points to some limitations in market scope if a market was to be considered based only on currently identified PEA areas. Therefore, in order to make an accurate assessment of the scope for an

PEA Region	Manufacturing	Construction	Retail Trade	Agriculture
Ipswich – Logan	129	114	54	–
Caboolture – Sunshine Coast	90	207	118	–
Bundaberg – Hervey Bay	18	27	33	18
Southern Wide Bay – Burnett	6	6	24	0
Townsville – Thuringowa	36	84	72	6
Cairns	42	70	69	30
North Western Melbourne	322	228	183	–
South Eastern Melbourne	441	222	210	–
Ballarat – Bendigo	54	66	87	15
North Eastern Victoria	33	36	48	42
Central – Coast Hunter	153	210	204	147
Illawarra	54	45	87	–
Richmond – Tweed – Clarence	–	51	81	51
Mid-North Coast	21	9	15	–
South-West Perth	78	72	57	–
North & Western Adelaide	240	204	189	–
Port Augusta – Whyalla – Port Pirie	–	6	12	6
North-West/North Tasmania	51	30	60	21

## APPENDIX TWO

## Detailed Impact Performance Indicators for Place-based Impact Investment.

Operational Impact Area	Impact Objectives	Sample Indicators collected for each reporting period	Sample Definitions
<b>Employees</b>	Employment of people residing in target area	<ul style="list-style-type: none"> <li>→ Number of full-time employees residing in PEA region and disadvantaged postcode</li> <li>→ Number of part-time and casual employees residing in PEA region and disadvantaged postcode</li> <li>→ Employment of previously unemployed persons from disadvantaged areas</li> <li>→ Overall employment contribution of FTEs to a PEA region and/or postcode;</li> <li>→ Number of employees from PEA/postcode still employed after 1yr, 2yr, 5yrs</li> <li>→ Number of female, Indigenous, disabled and CALD FTE employees</li> </ul>	<ul style="list-style-type: none"> <li>→ <b>Full-time</b> – As defined by Fair Work Australia: employees generally work 38 hours a week, and have a continuing contract of employment. Benefits such as paid sick leave, annual leave, holiday pay, long service leave and carers or other types of leave apply [see <a href="http://www.fairwork.gov.au">www.fairwork.gov.au</a>].</li> <li>→ <b>Part-time</b> – employees work regular hours each week, but fewer hours than full-time employees. They're usually given the same basic entitlements as full-timers, but pro-rata.</li> <li>→ <b>Casual</b> – employees employed on an hourly or daily basis and don't usually get paid sick leave or annual leave. They generally get additional pay called a casual loading to make up for this. Casual workers are also less likely to have regular or guaranteed hours of work. Notice periods do not apply to casuals upon termination of employment.</li> </ul>
<b>Wages</b>	Increased wages for low-income people residing in target area	<ul style="list-style-type: none"> <li>→ Value of wages (including bonuses) paid to all full-time and part-time residing in target area</li> <li>→ Value of wages paid to previously excluded persons residing in target area</li> <li>→ Wage equity ratio – calculation of wages of highest paid employee divided by be lowest paid employee.</li> </ul>	<ul style="list-style-type: none"> <li>→ <b>Low income</b> – people above the poverty line but below the national median income</li> <li>→ <b>Previously excluded</b> – persons previously unemployed for a period of 12 months or more</li> </ul>
<b>Training</b>	Employee training	<ul style="list-style-type: none"> <li>→ Number of trainees from PEA region and disadvantaged areas</li> <li>→ Number of trainees from PEA region who have progressed to employment</li> <li>→ Total Employee training hours</li> <li>→ Total Employee training costs (excluding wage costs incurred by employees during training)</li> </ul>	<ul style="list-style-type: none"> <li>→ <b>Trainees</b> – a person receiving training or undertaking a traineeship</li> <li>→ <b>Traineeship</b> – a system of vocational training that combines off-the-job training with an approved training provider and on-the-job training and practical work experience</li> <li>→ <b>Training</b> – development of skills, knowledge and competencies through instruction and practice</li> </ul>
<b>Suppliers</b>	Local Economic Development – multiplier effect	<ul style="list-style-type: none"> <li>→ Total supplier spend</li> <li>→ Proportion of supplier spend in PEA region and disadvantaged areas</li> <li>→ Supplier spend from social enterprises and social purposes businesses</li> </ul>	<ul style="list-style-type: none"> <li>→ <b>Supplier</b> – Business that provides goods or services to an organisation to help move a product or service from the organisation to its customer.</li> <li>→ <b>Supplier spend</b> – the amount of money spent on purchasing and/or procuring goods and services from other organisations or corporations.</li> </ul>
<b>Customers</b>	Local Economic Development – multiplier effect	<ul style="list-style-type: none"> <li>→ Total Sales</li> <li>→ Proportion of sales from PEA region and disadvantaged areas</li> </ul>	<ul style="list-style-type: none"> <li>→ <b>Customer</b> – person or organisation that purchases good and/or services from the business</li> </ul>
<b>Community Involvement</b>	Local Economic Development – multiplier effect	<ul style="list-style-type: none"> <li>→ Total value of dollar and in-kind contribution to local charities (ie. total value of charitable donations)</li> </ul>	<ul style="list-style-type: none"> <li>→ <b>Charitable donation</b> – financial contributions and in-kind donations of goods and services to non-profits or non-governmental organisations. Pricing discounts to non-profits do not count as charitable donations, only free services are considered to be in-kind donations.</li> </ul>

Operational Impact Area	Impact Objectives	Sample Indicators collected for each reporting period	Sample Definitions
<b>Governance</b>	Strengthened Governance	<ul style="list-style-type: none"> <li>Documented corporate governance policies</li> <li>Enacted corporate governance policies</li> <li>Number of members on the governing body</li> <li>Meeting frequency of governing body and committees</li> <li>Percentage of company that is owned by people residing in the target area</li> </ul>	<ul style="list-style-type: none"> <li><b>Governing Body</b> – the people who make up a body that administers and governs a company and is responsible for its governance (eg. a board of directors)</li> <li><b>Corporate governance</b> – the system by which companies are directed and controlled, including strategy, relationships, structure and performance monitoring</li> </ul>
<b>Social Policies</b>	Strengthened Social Performance	<ul style="list-style-type: none"> <li>Written social policies in line with recognised national standards (eg worker safety, employment benefits, equal rights policies).</li> </ul>	<ul style="list-style-type: none"> <li><b>Social policies</b> – a set of policies and procedures that set out a company's ethical and social responsibilities and how they will be enacted by the company.</li> </ul>
<b>Ownership</b>	Employee Asset-Building	<ul style="list-style-type: none"> <li>Policies and practices in place for employee asset-building</li> <li>Total dollar amount of benefits paid to employees through equity set-asides when a business is sold</li> <li>Policies and practices in place for enabling Employee Share Ownership Plans</li> <li>Total value of shares owned by employees</li> </ul>	<ul style="list-style-type: none"> <li><b>Employee Asset-Building</b> – practices that enable employees to develop assets such as savings, ownership rights and benefits, or other assets designed to build the long-term wealth and well-being of employees.</li> </ul>





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