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Impact Investing and Sustainable Development

I. Introduction

Impact investing has progressively emerged as a popular approach within the international financial system, aimed at “mobilising” private capital to achieve the United Nations' Sustainable Development Goals (SDGs). This strategy aims to bridge the significant funding gap that public finance cannot fill, particularly in developing countries. This deficit is due to the limited domestic resource mobilization, and to the unwillingness of donor countries to increase their official development assistance. The concept, which promises financial returns while simultaneously achieving social and environmental goals, has gained popularity, particularly in Switzerland, a country known for its financial system and its aspirations for sustainable finance. As impact investing is often presented as a panacea for development challenges, Alliance Sud’s study takes a critical look at its effectiveness, its limitations and the extent to which it can contribute to sustainable development.

II. The SDG Financing Gap

The financing gap that needs to be bridged to achieve the SDGs is huge and increasingly daunting; UN Trade and Development (UNCTAD) estimates that developing countries face an annual financing gap of over 4,000 billion USD. This deficit is not just a number; it reflects deep systemic problems that exacerbate this gap. The COVID-19 pandemic, climate crises and current geopolitical tensions have further accentuated this deficit, calling into question the optimistic forecasts often associated with impact investing. Despite the growth of the impact investment sector, our study clearly demonstrates that this approach alone will not be able to bridge the persistent financing gap and remove systemic and structural barriers to sustainable development.

Moreover, while impact investing is presented by some as a solution to this financial shortfall, there is a significant risk of over-reliance on private capital, which may prioritize financial returns over genuine development goals. This can indeed create a mismatch between the needs of the most vulnerable populations and the interests of investors, particularly in regions and sectors where high financial returns cannot be achieved.

I. The private sector as a key solution?

Impact investing is often promoted as an essential means of engaging the private sector in global development, aligning financial profitability with the achievement of social and environmental objectives. However, this alignment is often more theoretical than practical. The primary challenge is the inherent conflict between the pursuit of financial returns and the need for deep systemic social impact. In many cases, investments with real social and environmental impact are financially less profitable, which can lead to a potential dilution of impact in favour of financial performance.

Investments that genuinely address the root causes of poverty, inequality, and environmental degradation often require long-term commitments and involve higher risks; these are factors that are rarely compatible with the expectations of private investors. Additionally, the focus on financial returns can lead to the exclusion of the most marginalized communities and sectors, which may offer less attractive profit margins but have an urgent need for investment. This inherent conflict between profit and real impact raises fundamental questions about the real potential of impact investing as an effective solution to the challenges of sustainable development.

IV. Criticisms and systemic constraints of Impact Investing

A major concern is the risk of "impact-washing," where investments are presented as socially or environmentally beneficial without producing measurable results. This problem is exacerbated by the lack of universally accepted definitions and standards for impact investing, leading to inconsistencies in how impact is measured and reported.

Moreover, the emphasis on “mobilizing” private capital for development is leading to a reallocation of funds from official development assistance (ODA). This raises the question of whether this is the best possible use of limited (and dwindling) ODA funds. ODA, traditionally intended to meet the needs of the poorest and most vulnerable populations, can be diverted, undermining efforts in key areas such as health, education and basic infrastructure, particularly in regions where private investment is unlikely to flow in the absence of substantial public support.

A. Navigating Definitions and Impact Measurement

The impact investing sector suffers from a lack of standardized definitions and robust measurement tools, which undermines its effectiveness and credibility. Various organizations, such as the Global Impact Investing Network (GIIN) and the International Finance Corporation (IFC), have attempted to provide frameworks for defining and measuring impact. However, these frameworks are voluntary and do not guarantee consistent application across the sector. As a result, there is significant variation in the way impact is assessed, reported and communicated to stakeholders.

To address these weaknesses, there is an urgent need to develop binding standards and more rigorous impact measurement tools. These tools must be designed to account for both financial and non-financial outcomes, providing a clear and transparent picture of the impact generated by investments. Additionally, independent audits must be implemented to ensure that impact claims are backed by tangible results.

B. Systemic Constraints of Impact Investing

Despite its growth, the impact investing market faces systemic constraints that limit its ability to promote meaningful change. One of the most significant obstacles is the perceived high risk associated with investments in developing countries, particularly in regions with low credit ratings. These risks, which include political instability, regulatory challenges, and market volatility, deter many institutional investors from engaging in high-impact projects.

Another crucial challenge is the persistent debate between financial returns and social or environmental impact. While some impact investments can achieve both, the reality is that many high-impact projects require significant concessions in terms of financial returns. This tension between profit and mission is a fundamental challenge for the impact investing sector, particularly as it seeks to attract traditional investors who may prioritize financial performance over social outcomes.

Additionally, the illiquid nature of many impact assets, which often require long-term commitments, poses a challenge for investors seeking liquidity and short-term returns. This mismatch between the needs of impact investments and the preferences of many investors limits the market's ability to attract the necessary capital to develop projects with broader impact.

V. The Swiss Impact Investing Market

Switzerland aims to become a leader in global impact investing, with financial institutions and government agencies (State Secretariat for Economic Affairs/SECO and Swiss Agency for Development and Cooperation/SDC) intending to play a leading role in structuring the sector. For years, Swiss cooperation has encouraged blended finance, combining concessional public and private funding, through initiatives such as the Private Infrastructure Development Group (PIDG) and the SDG Impact Financing Initiative (SIFI). The next Swiss International Cooperation Strategy 2025-2028 aims to further strengthen partnership with the private sector, using "innovative" financial instruments to reduce risk in developing country markets, with the aim of encouraging private investment while strengthening the Swiss financial sector.

The Swiss impact investment players active in developing countries comprise some 18 managers who collectively manage close to USD 15 billion in capital. Of this amount, around USD 11 billion is invested in private assets (private equity and debt), which alone ensure financial additionality, unlike investments in secondary markets.

To put this figure in perspective, that is **0,589%** of the overall volume of "sustainability related investments" (SSF 2024) or **0,116%** of the total volume of assets under management (AuM) at banks in Switzerland in 2023 (CHF 8,391.7 bn).

The Swiss impact investment market is **highly concentrated** and dominated by three key players – ResponsAbility, BlueOrchard and Symbiotics – who control around 80% of market share, with the six largest managers holding 93%. It is mainly **concentrated in two regions**. Latin America and the Caribbean (24%), and Eastern Europe and Central Asia (20%), are the regions that benefit most from impact investments managed by Swiss managers; this is due to relative political and economic stability and an investment-friendly environment (with a few notable exceptions). By contrast, sub-Saharan Africa, the Middle East and North Africa receive only 13% and 2% of total investments, respectively.

Half of impact investments are **concentrated in the ten leading countries**. India leads with 15% of total exposure, followed by Cambodia, Georgia, Ecuador, and Vietnam. In total, 35 countries account for 85% of investments (considering only countries with at least 1% exposure). Among these, **19 are priority countries for Swiss international cooperation** (2021–2024). In terms of income classification, 17 countries are upper-middle-income (UMICs), and 4 are lower-middle-income (LMICs). **Only 4 are least-developed countries (LDCs)**: Cambodia (6%), Bangladesh (2%), Tanzania (1%), and Myanmar (1%).

The Swiss impact investment market is **also highly concentrated from a sectoral perspective**. Accounting for about half of the total assets under management, **microfinance** dominates the market. When combined with **SME development**, these two sectors make up over 80% of investments, reflecting their financial performance and priority status for fund managers. The Food & Agriculture (10%) and Climate & Biodiversity (4%) sectors receive far less significant investments, despite the dire financial needs in these sectors. **"Social sectors", which include Housing, Water & Communities, Health, and Education, together attract less than 2% of capital**; this is largely because these sectors do not offer attractive enough financial returns and are often managed as public goods by governments.

The Swiss impact investment market therefore tends to focus on regions and sectors that offer **lower risks and higher financial returns**. While these investments are significant, they reflect a broader trend in the sector towards "safe" investments that do not necessarily address the most pressing challenges in terms of sustainable development.

VI. Conclusions

Our analysis of general trends of impact investing and of the Swiss Impact investing market leads to the following conclusions:

1. Niche Market: Impact investing, while growing, remains a niche market globally, particularly in developing countries, due to high perceived risks, limited infrastructure, and insufficient investment opportunities.
2. Vague Definitions: Current definitions of impact investing are too broad, leading to inconsistent approaches and expected impact.
3. Challenges of Measurement: Measuring the actual impact of investments is difficult due to diverse methodologies and a lack of standardized tools. This inconsistency can lead to "impact-washing".
4. Reporting Issues: Inconsistent and non-transparent reporting reduces the ability to compare and evaluate fund performance, undermining trust and discouraging potential investors.
5. Geographic and Sectoral Constraints: Impact investing struggles to reach the poorest countries and key sectors such as agriculture and essential services. These areas often remain underfunded, requiring further reliance on Official Development Assistance (ODA).
6. Financing Shortfall: Impact investing alone cannot provide what is needed to close the financing gap to achieve the SDGs. It is crucial to prioritize domestic resource mobilization, tackle illicit financial flows, and maintain substantial ODA for the poorest countries.
7. Need for Market Transformation: Impact investing cannot replace the need for a fundamental transformation of global financial markets to align them with sustainability and climate goals. This includes implementing credible regulations, carbon pricing, and climate-related financial disclosures.

VII. Recommendations

A) To Regulators

If Switzerland wants to become a leader in the impact investment sector in developing countries – i.e., capitalizing on the strength and diversity of its financial sector and the expertise of the development community – it will need to:

1. Develop an ambitious national strategy in Switzerland, leveraging its financial sector and development expertise, involving private, public, academic, and NGO stakeholders. This strategy should include regulations, incentives, clear definitions, impact measurement tools, reporting, labels, and certifications.
2. Introduce a reliable Swiss label for impact investment products to standardize the market.
3. Enforce binding, legally enforceable transparency regulations, providing clients, investors, and regulators with legal recourse in cases of non-compliance.

B) For Impact Investors (even in the absence of regulation)

1. Clarify impact goals: Impact investments should aim for specific, measurable, and causal impact, beyond mere alignment with the SDGs.
2. Ensure transparency: Service providers must clearly explain how investments are managed for impact, define key performance indicators (KPIs), and continually monitor and optimize them.
3. Improve accountability: Regular, harmonized reporting on impact targets should use recognized, relevant indicators, including strategies, metrics, and achieved outcomes.
4. Rigorously scrutinize impact statements: Claims should undergo third-party audits, include community engagement, and present both financial and impact results.
5. Impact investors should collaborate with NGOs to leverage their expertise, provide concessional capital, and target enterprises in sectors or regions where NGOs are active, helping create jobs and improve access to essential goods and services.

C) For Development Agencies (including SECO and SDC)

1. Use blended finance to de-risk projects in LDCs, complementing but not replacing grant-based aid.
2. Set clear social and environmental impact goals as conditions for subsidies/grants (i.e., via blended finance initiatives).
3. Require precise definitions and reporting from impact investors that benefit from ODA funds.
4. Ensure that grants are tied to measurable results and benefit priority countries for Swiss international cooperation.
5. Use their convening power to encourage philanthropic organizations to fund project pipelines through TA contributions and use their influence in target countries for political dialogue to reduce risks in those countries.
6. Ensure that impact investments (supported by the public sector) align with developing countries' priorities.

7. Help partner countries adapt their regulatory frameworks to facilitate local impact investment.

D) For Philanthropic Organizations/Private Foundations:

1. Pursue a dual strategy of investing part of the endowment for impact and using programmatic funds to support locally sustainable entrepreneurial initiatives.
2. Allocate funds to high-risk, high-impact initiatives, including grants and patient capital for business incubation, acceleration programs, and other impactful activities.
3. Support research and development (R&D) initiatives, including academic research, pilot programs, and feasibility studies for social or environmental innovation.
4. Promote best practices and share knowledge to encourage others to engage in impact investing.

E) Potential roles for NGOs (international and national):

NGOs can play a crucial role as facilitators and partners in impact investing. NGOs often have in-depth knowledge of local contexts through their long-standing presence in countries and through local staff.

1. NGOs can help to understand local needs, identify opportunities, and mitigate risks associated with impact investments.
2. NGOs can provide valuable sectoral expertise on specific social or environmental issues. They can provide advisory services to impact investors to build local value-chains and validate business models and investment opportunities.
3. In some cases, local NGOs can act as intermediaries or "honest brokers" between investors, social enterprises, and communities.
4. NGOs can contribute to monitoring and evaluating the impact of investments.
5. NGOs can provide training, mentorship, and technical assistance to intermediary financial institutions and social enterprises.
6. NGOs can capacitate local partners to run incubator and accelerator programs to support early-stage social enterprises.

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