Quick Case Guide			
Public Foundation	Publicly Fundraising	Mostly Direct	Finance First
Private Foundation	Non-Fundraising	Mostly In-Direct	Blended
			Impact First

Catalyzing community impact through partnerships

In conversation with the Lundin Foundation, February 2017

The Lundin Foundation is a registered non-profit supported by the Lundin Group of Companies globally and headquartered in Vancouver. The foundation seeks to support the building of resilient communities wherever the Lundin Group operates. In addition to managing significant initiatives in capacity building and technical assistance to enable communities to benefit from resource development projects, the foundation is an active impact investor that has incubated the creation of new funds. Purpose Capital spoke with Stephen Nairne, the Lundin Foundation's Managing Director, about how the foundation thinks about impact investing for economic development in emerging and frontier markets, and the role of direct investing.

"While investing directly requires more time and resources, for us, it's been a more meaningful way to see how our investments are changing lives."

What does impact investing look like at the Lundin Foundation?

We began impact investing in 2008. I was very fortunate to have been invited to a meeting convened by the Rockefeller Foundation with 30 to 40 others in Bellagio where the term 'impact investing' was coined. Since then in Canadian dollar terms we've deployed about $80 to $90 million in Sub-Saharan Africa. We started in a Canadian office. Our initial exposure was almost exclusively through what we would call pooled investment vehicles such as funds. We began that way to gain experience and traction, to meet co-investment partners and to participate in syndicates. Then gradually in 2010 and 2011 we transitioned that strategy toward more direct investing. To do so we opened our first office in Nairobi, Kenya in 2012, and a second office in Accra, Ghana.

Over the last three or four years we've built a portfolio of direct investments. We are focusing on three sectors: agriculture, energy access and financial inclusion. We chose these three sectors because, in our judgment, they are most explicitly linked to our target beneficiaries — people living at or near the base of the economic pyramid. Out of necessity, we've added a fourth pillar to our strategy that focuses on human capital development. While from 2008 to 2011 access to finance was the primary barrier for social enterprises and small and medium-sized enterprises in Africa, we feel that this has started to change. Today talent is now the major scaling variable. We have now allocated more than 85% of the money here toward impact investing, and are looking to build on that experience with AHL Venture Partners.

KEY STEPS

- *Focus on understanding the impacts you want to achieve*
- *Start with funds to gain experience and begin to understand the sectors you're interested in*
- *Find opportunities to make the impact tangible through site visits or meeting entrepreneurs in person*
- *Lean into direct investing if you want to build businesses and see more tangible impact from your work*

What has motivated this now strong focus on impact investing in emerging markets?

That's a great question. The Lundins are a family of entrepreneurs. They have a very strong sense of giving back in sort of the Andrew Carnegie way. They have been very fortunate, but strongly believe in the philosophy of a hand up rather than a handout. They had a lot of mixed experiences with traditional forms of philanthropy. I went with them on a couple trips early on and I could see that they felt that this was not leading to sustained improvements, that there were not really solution-oriented approaches to a lot of these issues. So, I had a very receptive audience for looking at more market-based solutions. At that time they had already been doing business in Africa for 25 years. I think that from their perspective and mine, the poorest person in the poorest village in the poorest country would prefer a job rather than a handout. A job gives that individual the dignity to make choices about his or her own life. For the Lundins this was not just the right thing, it was also the smart thing to do. They have a sense, as you and I have, that capitalism is shifting. They understand that companies that recognize inequality and see it as a problem, but also as an opportunity, are companies that over time will be more successful and will scale more easily. I just think that they fundamentally understood it.

If I were to say, "What was the founding moment?" That's when the lights went on. I thought we could build a foundation around concepts of entrepreneurship and private sector development. I'm not somebody who believes that impact investing is a panacea that will solve all problems. It won't. It's very effective for some problems, less effective for others. However, to me, if aid is ever to have an endpoint, you need to create a private sector and relationship between civil society and government through tax. How will African governments ever fund health or education and infrastructure unless they have a tax base? If all of that is funded in perpetuity through grants, then we don't build the private sector. We are creating dependency and we are doing so deliberately. I have a fundamental problem with that.

I didn't know about impact investing until I was invited to this meeting. From that, I was extremely excited on a conceptual level. I went back to the family. It was a concerted decision that we would look now to shift our approach and gradually shift our assets. But we did so cautiously at the beginning. By 2010, we had a strategy: focus only on impact investing and gradually build an endowment. If we were going to be effective, we needed to have boots on the ground.

What kind of process did you follow along the way to investing directly in emerging markets?

We began by doing a lot of benchmarking in Africa around where there were real capital supply deficiencies by region, sector and transaction size. This benchmarking exercise was one of our guiding activities. On the financial side, we started slowly — I should emphasize that. If I showed you a chart, the first two or three years indicate very slow and incremental growth. But over the last few years we've been investing much more, and more quickly. I also think, speaking with humility, we had a lot to learn. It's not easy to suddenly start investing in Africa and be successful. We've really honed our skills now. It's not something that you learn in a classroom. It's learning by doing. It's important for boards to be able to visualize what's happening, because it can become a very abstract sort of thing. It can start to not feel like you're not a charity anymore. So we've also done more than a dozen board trips to visit the businesses and projects.

Once we had done a couple of direct investments, we started to build a team. We had matured as a team and sort of gelled. Fundamentally, I sense that it's very hard for trustees to connect to funds in a meaningful way. You can say: here's the fund, here's the gross and net IRR, here are some examples of portfolio companies — but I find that over time funds don't resonate in the same way as direct investments. With direct investments, you're often involved in governance, you're getting quarterly accounts, narrative reports, you're participating in investor meetings. I think the impact of the money feels much more real.

The Lundins have always had a lot of connections with the Aga Khan Development Network. One might reasonably advance the argument that the Ismaili community was the original impact investor and that this approach may go back in 80 or 100 years. I remember taking the Lundin family to see Frigoken, which is a green bean business just on the outskirts of Nairobi. They were buying green beans from 100,000 farmers in western Kenya. This is another very formative moment. I could see the lights go on: this is a business that is making money, that is permanently improving food security and incomes for 100,000 people in western Kenya. It was an Aga Khan company that had been business forever. I can still remember the family looking at this and you could see them going "Wow." In a way that was the prototype transaction for us, because we started with agriculture, then added financial inclusion, and later added energy access.

In what ways has direct investing changed how you operate?

One of the ways direct impact investing differs is that it is so high touch. I'd say the due diligence and transaction structuring is only 10 to 20% of the process. For us, the post-investment value creation, remediation, fundraising and corporate governance recruitment — this is really the work. It has made me change how we hire. We used to hire people with investment backgrounds. We still need at least three people with those backgrounds. But we now hire people with operational backgrounds because that's what is credible. Have you done sales and marketing before? Do you understand inventory management and supply chain? How do you really drive growth in these businesses? We've restructured a little bit in that way, where we have the finance and investment team in London and Vancouver and then we have a lot more operational people. Some of them also have really good investment track records, but we've tried to kind of mix it up a little bit that way. For our type of direct investing, we found that to be very, very important.

How has your impact investing performed compared to your expectations?

I have set those expectations deliberately low, so our target return in financial terms is 6 to 8%. I'm going to borrow some language from one of our partners; we think of this in terms of the 'efficient impact frontier'. So, for any level of impact that we want to achieve, what sort of financial return can we achieve as we look at that? We have a few investments that will end up getting a 20 or 30 times return. These are investments where we see profit and purpose intersecting. We're lucky because so far we can do everything operating as a single LP fund: grants, convertibles, debt, equity… and everything in between. We're divided right now between what we call a venture lab and our normal investments. Venture lab investments are typically $250,000 convertible debt instruments often staged against milestones. For our normal impact investments, the investment size is probably $500,000 to $5 million. Overall, we have a net IRR of 7.3%, which for me is immensely satisfying. If you look at just our direct investment side, on the equity side we're at 23% net IRR. For me, this is important validation.

How does AHL Venture partners serve to continue this work?

We've recently created a dedicated impact investing entity supported by the Lundin Family — AHL Venture Partners. Opening up our work to others is one of the reasons why we've decided to go to the market with it. I have, for a long time, felt very embarrassed as a Canadian by how far behind we are in impact investing. I think there is a lot of money in Canada that is intrigued by this, but there isn't a lot of intermediation. We don't have many user-friendly or user-centric tools that allow people to understand the space. It is a large impetus for us to raise a fund predominately, if not exclusively, from Canadian investors. Because what we've created is not a traditional fund, it's what we call a co-investment syndication platform. We have offices on the ground, we have rights to future share offerings in some of Africa's most promising social enterprises. We've tried to create a low cost, low risk structure that will allow high net worth individuals, family offices and foundations to get access to a small, heavily curated set of deals that have high growth potential and phenomenal impact.

Are there particular entry points you think would help Canadian foundations along?

The first thing is to think carefully about the impact you want to create. Fundamentally, everything must be organized around the impact you hope to achieve. Then you can think carefully about geography, about the sectors and about where you see capital being most effective. That is the starting point. I still think it is better to start with funds because inside one fund you'll begin to develop the ability to look at how different things compare. Inside a fund you may have eight, 10, 25 different investments. You'll be able to observe how they grow or fail and you'll gain experience. More importantly, you'll gain access to other investors who have different experiences, which I think is very helpful.

I don't think I would change any of that. Again, we didn't sit down in 2008 and say, "Okay, let's start by doing venture philanthropy, primarily grants, then funds, then directs." It happened organically. I don't think it could have happened any other way.

The other thing I would emphasize: impact investing is very difficult. To be successful, you need to be disciplined and focused, which means honing in on a limited set of development challenges and gaining as much expertise as you can around those challenges. We see a lot of exceptional opportunities in education or health or water. I'm intrigued by all of them, but we don't have any resources to effectively evaluate those opportunities. We are determined to remain specialized.

How would you describe the differences between directly investing and fund investing?

The decision to shift to direct investing strategy presupposes that you have solidified your strategy, that there is a long, and I mean long term, commitment to that strategy — at least eight to 10 years. You must be willing to put boots on the ground and accept a higher level of risk, but also a much stronger sense of being actively involved in the impact. It's the distinction between being a bird and a bird watcher. When you invest directly, you feel more like a bird, whereas when you invest in funds, you feel like a bird watcher.

For many foundations, there will always be the need for more passive approaches to investing because of the work involved. The shift to direct investments has an enormous implication in terms of resources. I think the creation and support of new funds is going to be fundamentally important. I wouldn't stand up and say, "What we did is really the model for others." I don't believe that. A lot of foundations have one or two staff, or maybe four or five staff. They're not going to be able to execute this strategy unless they make a concerted effort. The decision to get into direct investing is going to be very specific to different foundations and whether you want to go down that path. The implications are significant.

The upside is: you get a much more tangible sense of impact. With funds, you get a report every quarter and you participate on a call. You might get invited to the field occasionally, but you don't get the feeling that you're building a business. To get into direct investing you must hire repressed entrepreneurs. You have to hire and retain people who are really committed to building businesses that have impact. I find investing in funds less interesting and rewarding than doing direct. I'm a repressed entrepreneur too. So in a way, this may be how the strategy evolved. Direct investing is different and I don't think it is necessary. It’s not better or worse; it just has implications. The downside is more time and resources, the upside is that you get a much more meaningful sense of how your dollars are changing lives.