How responsible investing in financial services makes an impact

Janet McKinley *(www.advanceglobalcap.com)*

Investments that seek a double bottom line – financial return and social impact – consider more than profit in their calculation. For the patient impact investor, financial services in emerging markets that focus on financial inclusion have the potential to generate both commercial returns and sustainable impact. When properly structured, they can withstand the turbulence of purely profit-seeking assets and lay the foundation for economic stability and growth.

Janet McKinley

Impact investing and financial inclusion

At Advance Global Capital (AGC), the financial services company I co-founded in 2012, our goal is financial inclusion by helping to build strong financial ecosystems that support small- and medium-sized enterprises (SMEs) in emerging markets.

When I think about impact investing from a financial standpoint, I think about responsible investing, seeking a commercial rate of return grounded in a responsible allocation of capital. We carefully choose where we invest, because the consequences of pulling out of an investment based purely on short-term profit considerations can reduce the long-term impact of the strategy.

Consider the challenge for a food products manufacturer in Kazakhstan. Market demand is local, and demand for the goods is thriving. But uncertainty regarding global interest rates and the collapse of oil prices around the world now limits access to working capital and threatens the stability of the business and community.

The carry trade and local business disruption

Money is moving faster and in greater volumes than ever before, making local, and especially emerging, economies vulnerable to conditions beyond their control. With an unprecedented string of years where central banks have pursued a zero interest-rate policy, the carry trade has exploded. Forbes calls it 'the multi-trillion dollar hidden market'.

How does it work? Borrow cheap dollars, lend at a higher interest rate somewhere – such as in emerging markets – and earn the spread. It works, until it doesn't any more. The collapse in oil and other global commodity prices, along with speculation regarding U.S. Federal Reserve interest rate targets, have triggered a tsunami of foreign capital back into dollar-denominated securities. This has taken its toll on local currencies and the balance sheets of local corporate borrowers.

With capital flowing out of emerging markets even faster than it came in, local enterprises have had to deal with the dislocations. Corporates, which borrowed in dollars, now face higher repayment costs due to devalued local currencies. Local financial institutions have less credit to offer aspiring businesses – even if their prospects are good – and the cost of that credit is higher. The Kazakh food products company no longer has access to reasonably priced working capital to cover the gap between when goods are delivered and when the corporate supermarket pays for them. Cash flow is strained all along the supply chain.

Investing in emerging markets to sustain growth

AGC takes a measured approach to trade financing in emerging and underserved markets to deliver an attractive absolute return while contributing to greater financial inclusion. We work with local non-bank and banking institutions to build a more sustainable financial ecosystem with a focus on invoice discounting and supply chain financing for small- and medium-sized enterprises (SMEs), particularly women-owned businesses.

- Confirmed invoices have an established face value upfront, which the buyer pays months later.
- The discount rate on purchased invoices is not tied directly to any public market rate, such as LIBOR.
- Pricing reflects the credit worthiness of the buyer, the local factor's financial strength and the rate of return a business expects to earn if it can put cash back to work immediately.
- Liquidity is based on the invoice terms – generally 30 to 90 days.

As global financial circumstances change, AGC works closely with factors to evaluate risk and return. Credit lines can be reduced, rolled or expanded on a monthly basis, depending on the potential return and the overall portfolio risk. The factor hedges out the local exchange rate risk, locking in predictability for the time the assets are held. If the cost of hedging is prohibitive, it is a market-warning signal.

Know your customer

Our origination team works with local factors, and meets with suppliers and their buyers to understand local conditions. From 30,000 feet, the terrain may look difficult. It may seem prudent to pull out of a market if short-term benefit are all the investor seeks, but on the ground, there are often solutions and opportunities.

A few months ago, our team travelled to Kazakhstan to meet the local food manufacturer and understand his challenges today and the potential for his business and community in the future. The people we finance have good businesses. They make things people want to buy. Good impact investing is grounded in the place where money is put to work. That stability is an important measure of success in impact investing. It's not a 'bet'. And it's not a show. At Advance Global Capital, we don't talk about fund 'performance'. We want to see positive results.

Janet McKinley, *co-founder of Advance Global Capital (www.advanceglobalcap.com), has over 25 years of investment experience, having managed global portfolios in 3 of the 10 largest equity mutual funds in the US. She retired in 2004 as a director of Capital Research and Management Company (assets in excess of US $1 trillion) and principal executive officer of The Income Fund of America. An active philanthropist for over 20 years, Janet is Chair Emerita of Berkeley Endowment Management Company where she continues to serve on the board, with prior service as Board Chair of Oxfam America, and Board Trustee of Oxfam International, Smith College, the Deutsche Bank Microfinance Consortium Fund and MicroCredit Enterprises. She was a Fulbright Scholar, received her BA degree from Smith College and attended New York University Graduate School of Business.*