

# Impact Investing in Central America

## An Analysis of the Growth, Diversity and Potential of a Young Investment Strategy in an Emerging Market

by

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### Abstract

*Impact investing is an investment strategy that over the past decade has begun to receive considerable attention in regions around the world, and Central America is no exception. However, it is a region of widely varying socioeconomic, political, and financial environments spread across several relatively small economies, making impact investing, an already difficult, changing process, even more dynamic. This chapter will help contribute to an understanding of the current status of the impact investing sector in Central America, including identifying current obstacles, outlining the investment pipeline for investors and briefly profiling existing investors. Future steps for the sector will also be addressed as well as the importance of furthering the understanding of the impact created from business.*

**Keywords:** Impact Investing, Central America, emerging markets, social enterprise

## I. Introduction

We are concerned about the positive impact created from our investments because we are concerned about the sustainability of society. We are concerned about the sustainability of society because we know that there cannot be successful businesses in failed societies and when a society is not sustainable, it will inevitably fail. Economics has shown us the path towards efficient business, but it also recognizes the issues created from ignoring or failing to manage negative impacts<sup>1</sup> of business. Additionally, throughout society we are shown figures relating to growth such as GDP, housing markets, stock markets, etc. but this growth is often directionless. And as E.F. Schumacher stated, “There can be ‘growth’ towards a limited objective, but there cannot be unlimited, generalized growth” (Schumacher 1978). We have to give growth direction, to pursue specific objectives to be able to consider sustainability a realistic goal for society. While still developing, impact investing is the form of investment that intentionally seeks to create specific positive impact from the operations of the business.<sup>2</sup> It represents an important step towards recognizing the need to more fully understand business impacts on society as well as giving growth a sustainable direction.

Due to the recognition of the potential power of impact investing, namely, utilizing market forces to achieve specific social impact goals, the sector has begun to receive attention from a range of interested parties around the world including foundations, governments, investment firms, multilateral institutions, universities, among others.<sup>3</sup> Despite the growing amount of resources being devoted to understanding and carrying out impact investments, there is much that remains to be seen. In particular, we have realized that there is no cookie cutter format for making a successful impact investment. As a result, there is a range of investment vehicles and support mechanisms being implemented to grow impact oriented

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<sup>1</sup> In economics this impact, whether negative or positive, is often referred to as an externality when it is an impact that is not accounted for in the cost of the transaction. Their occurrence and prevalence is often considered a result of imperfect information and/or the high transaction costs necessary to resolve the negative impact.

<sup>2</sup> An important aspect about impacts (and externalities) from business is they are nearly limitless in number whereas the impact metrics used in an investment are often limited and may only measure a few relevant items.

<sup>3</sup> Examples include: Rockefeller Foundation, United Kingdom, Overseas Private Investment Corporation, JPMorgan Chase, The World Bank, Cornell University, Harvard Business School, etc.

businesses, those businesses with an explicit social/environmental mission. Determining a suitable form of investment can depend in large part on the existing socioeconomic, political, legal and financial environment in which the investee operates as well as having a strong understanding of the motives for the business itself. When these factors vary significantly across the region an impact investor is operating, the investor must either decide to focus and specialize in a single form of impact such as ‘clean technologies’ or the investor must have enough flexibility and knowledge along with a clear vision of their impact goals to be able to invest across impact themes. For example, investing in businesses that provide access to basic services to customers living in poverty while also being able to invest in businesses developing clean tech. Each of these sectors will tend to have unique business structures and different types of customers but can still be capable of generating substantial social and/or environmental benefit while also being financially profitable.

Central America consists of a region with considerable diversity of opportunities, with widely varying conditions between a series of relatively small countries. This diversity undoubtedly presents a challenge from an investment perspective, but also significant potential to those who can develop an implementable investment framework to recognize and support impactful businesses of many types. In the past decade, investments in impact oriented businesses have grown in the region with the rise of boutique impact investment firms, social enterprise accelerators, sustainability oriented institutional investors, etc. In this chapter, we will discuss the impact investment sector in Central America, its current status, how it has grown, its future potential and how lessons learned thus far can be used elsewhere in the world.

## **II. Impact Investing Outline: What it includes and what it does not**

Throughout this chapter we use the World Economic Forum’s (WEF) definition of social impact: “intentional positive outcomes that a business explicitly sets out to deliver – not side effects of a core business activity” (WEF 2013). We find this definition to be both specific and operational. Given this, we utilize WEF’s definition of impact investing: “an investment approach that intentionally seeks to create both financial return and measurable positive social and/or environmental impact” (WEF 2013). It is important to note that the social and/or environmental impact must be measurable. Without being

measurable there is no way to track the progress made. This stems from the old adage that we must measure what matters and once we can measure it, we can begin to manage it. Thus, a core element of impact investing is the emphasis on expanding measurement techniques to areas of social and environmental impact, not just financial performance. With new metrics, we can extract new, improved information about how business impacts society. And as we slowly strive towards a status of perfect information we will effectively be able to minimize and eliminate net negative impacts on society.

Additionally, impact investing is an “approach” to investing and not an asset class. It can be applied across the spectrum of asset classes from private equity to public equity to real assets. However the areas of greatest advancement within the field of impact investing are often found at the entrepreneurial level, with venture capital and venture philanthropy driving the creation of new and growing businesses with one of a kind business models incorporating social and/or environmental impact as a core aspect of their business’ operations, not just as a CSR (Corporate Social Responsibility) initiative.

### **III. Business in Central America: The Socioeconomic and Political Environment**

In a report for the Inter-American Development Bank (IDB), Vives et al. (2011) states that in a developing country, a company should have a more comprehensive vision of long term business strategy than is typical in a more developed country. In a developed country, the economic and social development is not the responsibility of the company. However, in a developing country, the public sector and civil society may often be the heavily influenced by the company.

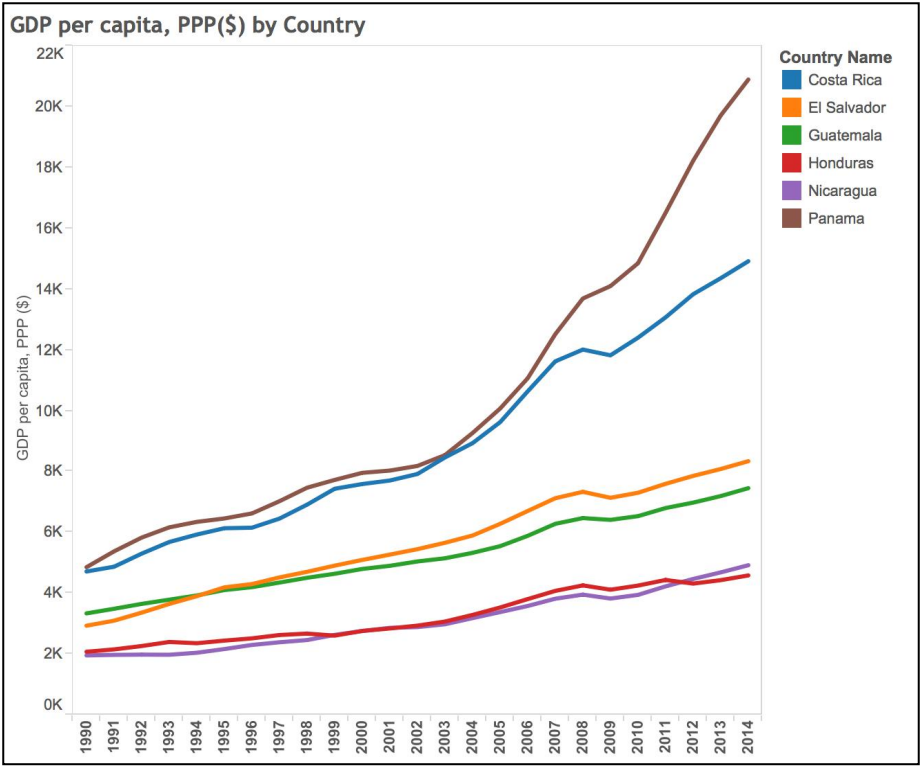
As a result, companies have a stronger call to engage in impact investing when underfunded governments are unable to provide the necessary social or environmental protections. This is especially apparent in a region such as Central America, where rule of law may be lacking, and traditional, purely profit driven companies are more able to take advantage of weak law enforcement. It will likely take decades of cultural adjustment before governments across Central America would be capable of taking care of their citizens without the assistance of private capital. As a result, companies in Central America must work to improve their society so as to ensure their company’s longevity given that the government’s ability to maintain and improve conditions may be lacking. However, effectively supporting those impact oriented

companies that exist by grouping Central America into a single understandable impact investing region is easier said than done. While each country may be relatively small and located near each other, the socioeconomic and political environments vary considerably.

Starting from the southern end of the region, Panama is a country that has seen relative political stability and is recognized for being a major finance and trade center for the region thanks in large part to the canal and the longstanding relationship with foreign investors such as the United States. Next is Costa Rica, another country with relative political stability, recognized for having abolished their army in the late 1940's and being a world leader for its environmental policies. Similar to Panama, Costa Rica has a relatively high GDP per capita as can be seen in Figure 1 (World Bank 2015). In Nicaragua, we find one of the poorest countries in the region with one of the highest poverty rates at 42.5% (World Bank 2015). For decades up until the 1990's Nicaragua suffered from political upheaval and war. The high levels of poverty and current relative stability have made it a common site for foreign philanthropic efforts.

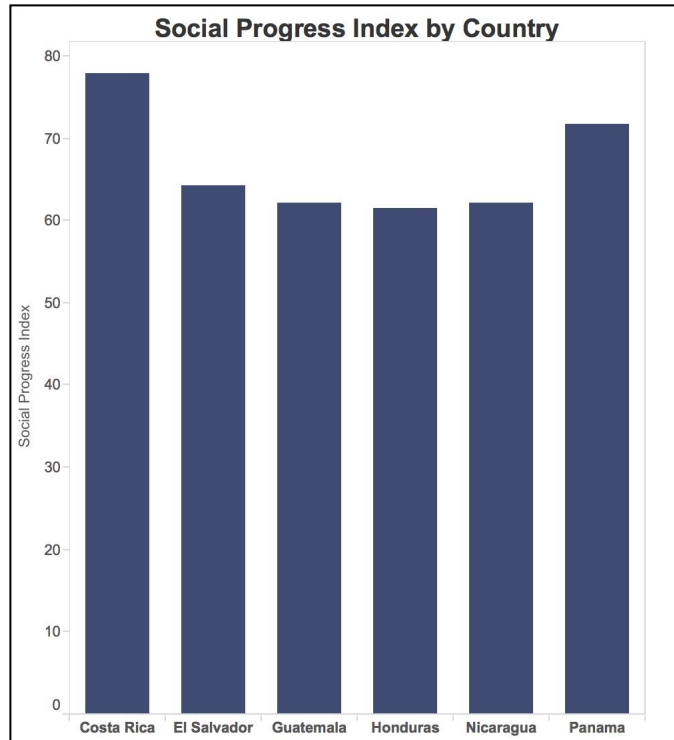
The remaining three countries, commonly referred to as the Northern Triangle, consist of Honduras, El Salvador and Guatemala. Guatemala is currently suffering from major political instability as both the president and vice-president resigned recently amid a corruption scandal. Honduras is also undergoing a prolonged period of political instability since a coup d’etat in 2009 as well as being one of the most violent countries in the world, suffering from large-scale gang violence and drug trafficking. As can be seen in Figure 2, Honduras and Guatemala, along with Nicaragua rank similarly low in the Social Progress Index (SPI), a measurement framework for national social and environmental performance (Porter and Stern 2015).<sup>4</sup> Meanwhile, Costa Rica and Panama rank significantly higher. Finally, El Salvador is a geographically small country but with a population similar to Nicaragua, a much larger country. Like Guatemala and Honduras, El Salvador has also struggled with government corruption and suffers from widespread gang violence. Despite this, it still maintains the third highest GDP per capita for the region as visible in Figure 1.

**Figure 1: GDP per Capita, PPP (\$) by Country (Source: World Bank, 2015)**



<sup>4</sup> “Social progress is the capacity of a society to meet the basic human needs of its citizens, establish the building blocks that allow citizens and communities to enhance and sustain the quality of their lives, and create the conditions for all individuals to reach their full potential” (Porter 2015).

**Figure 2: Social Progress Index by Country**  
(Source: based on data from Porter and Stern, 2015)



#### **IV. Impact Investment climate in Central America**

There are deep-seated cultural elements that greatly influence the investment climate of Central America. Shah et al. explain that fundamental issues for the region include the “small size of individual economies, businesses, culture of family ownership and aversion to minority shareholders, lack of equity culture among investors, etc.,” none of which can be quickly resolved (Shah et al. 2007). These cultural obstacles and their impact on the local financial markets will limit the ability of impact investors to make investments in a way similar to in a more developed financial market.

The equity and private debt markets in Central America are poorly developed and in some areas do not exist at all. Only the countries El Salvador, Panama and Costa Rica have an equity market (Shah et al. 2007). Secondary markets across the region are also poorly developed. This lack of equity markets and secondary trading reduces the options for an exit from a venture capital investment, making an Initial Public Offering often unfeasible.

In addition to the cultural, political and socioeconomic challenges found in Central America there are several other obstacles specific to impact investing. Many of these obstacles are relevant to impact investing around the world, not just to the sector's current status in Central America.

- *Lack of track record of successful investments* – Many of the investees as well as the funds investing in them have only been in business for a couple of years. In fact, the term ‘Impact Investing’ was only coined in 2007 (Rockefeller Foundation 2015). With such a young age, very few private investments have been successfully exited. There still exists a wide variety of fund structures, business models, etc. in part because of the diversity of the region and the search for the most effective structure.<sup>5</sup>
- *Shortage of quality investment opportunities* – Because this sector is relatively new, the number of investment opportunities is low. Many companies do not know how to measure specific social/environmental impacts, how to market themselves to an investor if they do measure impact and/or how to find an appropriate investor in an environment lacking developed financial infrastructure. Investors will have to develop strategies for finding the investees as well. Seeking and creating these types of opportunities will require developing expertise in the sector.
- *Inadequate impact measurement practices* – Impact metrics are still not measured consistently, largely because there are many definitions of impact and many different types of companies operating with different objectives, products, customer bases, etc. The Impact Reporting and Investment Standards (IRIS) is an initiative by the Global Impact Investing Network designed to help overcome this obstacle by cataloging the most useful impact metrics relevant to every type of investee.
- *Lack of common vernacular for talking about impact investing* – New terminology is regularly being created and defined, often overlapping with existing terms, as more players continue to enter the market, leading to confusion. As mentioned, the term ‘impact investing’ is less than 10 years old and requires a definition for both ‘impact’ and ‘investing’ to be effectively understood.

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<sup>5</sup> Retroactively labeling impact investments can prove valuable for recognizing successes and building a track record.



Additionally, types of investees have acquired a range of terms, which will be addressed later in this chapter. Development of new impact oriented legal entities could help overcome this issue.

- *Uncertainty regarding achievement of stated impact or financial objectives* – As an organization grows, it may focus more on financial return than on social return or vice versa, meaning stated impact or financial objectives will not be met. If an investee appears to achieve financial success without fulfilling its stated impact objective, the reputation of the investor as an impact investor will likely be tarnished. Additionally, if an investee fails to provide the necessary financial return, the impact investor soon will not have the resources to make further investments. This is why investors in the impact investing space must try to find investees that have impact objectives as a core function of their business model.

## **V. Financial Instruments for Impact Investing**

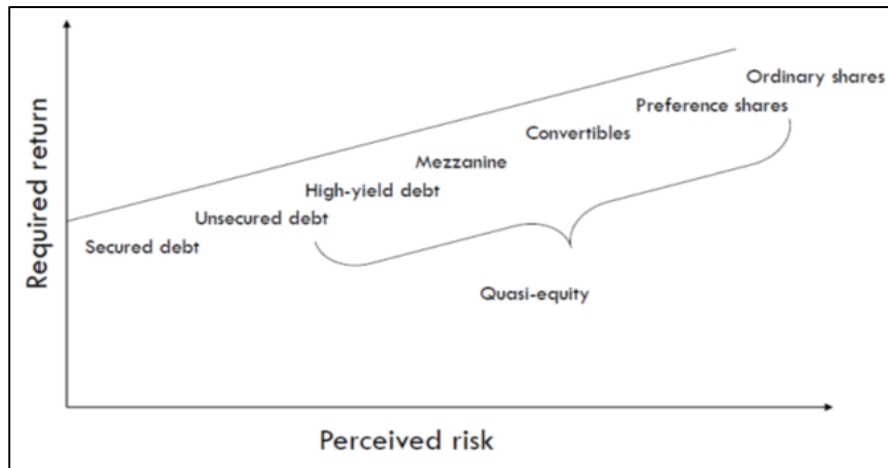
A business' life cycle can be broken down into three primary stages: seed, growth, and scale. Depending on the stage of the business, different financial instruments, (i.e. grants, loans, equity, etc.) may be best suited to support the business' successful movement to the next stage. The type of capital available also depends on who is providing that capital (a foundation, a venture capital fund, etc.) and their expected rate of return, if any.<sup>6</sup> Figure 3 below, taken from the Aspen Network of Development Entrepreneurs (ANDE) displays the risk/return profile of the various financial instruments<sup>7</sup> and in particular, how the various types of quasi-equity compare (Webster 2013).

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<sup>6</sup> As in traditional business, the seed stage of a business often begins with family and friend funding. Foundations and nonprofits can also provide seed capital in the form of grants and grant-like instruments (such as forgivable loans). In the case of a socially oriented business, the second stage, growth, could be funded largely by social funds through a series of soft loans, trade credit, and equity. The scaling stage is dominated by social venture capital funds that invest primarily through convertible debt and equity instruments. These investors can inject a greater amount of capital and generally have expertise in bringing businesses to scale in target markets (Kohler et al. 2011).

<sup>7</sup> In this case, all are seeking a financial return of some kind.

Figure 3: Risk – Return Spectrum of Financial Instruments (Source: Webster, 2013)



The category of quasi-equity, as visible in Figure 3, while less typical in the traditional investing arena, has received more attention in the impact investing community. There are three standard types of quasi-equity used in impact investing (Kohler et al. 2011). These include:

- *Subordinated debt* – the simplest form of quasi-equity. It is unsecured debt or debt that is junior to secured debt.
- *Convertible debt* – debt that is redeemable or convertible into ordinary or preference shares
- *Royalty/profit participation* – an income note or other redeemable instrument that attracts a return linked to the revenue or profit performance of the investee (Kohler et al. 2011)

The use of these different financial instruments can also help to overcome some of previously mentioned obstacles facing the impact investing sector. For example, because many small businesses in Central America have an aversion to selling equity in their business, these quasi-equity instruments may act as debt, thereby not requiring the owner of the business to sacrifice any of their stake. Meanwhile, a debt instrument with profit participation helps the investor enjoy some of the upside of the business' growth.

Furthermore, use of subordinated debt can help reassure the senior/secured debt lender, reducing their risk, while also increasing the amount of funding available to the impact oriented business.<sup>8</sup>

## **VI. Returns on Investment**

Impact investment opportunities vary from market rate, below market rate, capital preservation or venture philanthropy/grants. The rate of return depends in part on the financial instrument used, the type of company being invested in and the sources of capital being used by the investor. As a point of comparison it is important to first note the typical returns on investment in Central America for traditional, non-impact oriented investing.

A traditional private equity firm in Central America will look for an ROI around 20-30% depending on the industry and risk level. Larger infrastructure projects, such as energy, will look for at least 12% (Corrales Salas 2013). With debt instruments, the rate of return is considerably lower. Average interest rates from Banco Nacional in Costa Rica range from 5% for short term loans (up to 6 months) in USD to just over 9% for long term loans (over 3 years) in USD. Rates increase to about 8% and 13% when pegged to local currency (Corrales Salas 2013). Actual values will vary by industry. For small and medium enterprises, various types of loans are the most common source of financing using such instruments as working capital loans, investment loans, and factoring.

Many impact investing funds pursue competitive risk adjusted market rates of return. In a review of funds conducted by ANDE and published in their 2012 Impact Report, the average impact oriented fund had a target IRR of 17%<sup>9</sup> (Kohler et al. 2013). Funds in this category raise capital from the market; their investors expect a return on investment and are sometimes willing to accept below-market rates. The IRRs achieved in this category are broken down in Figure 4 below by types of financial instrument based

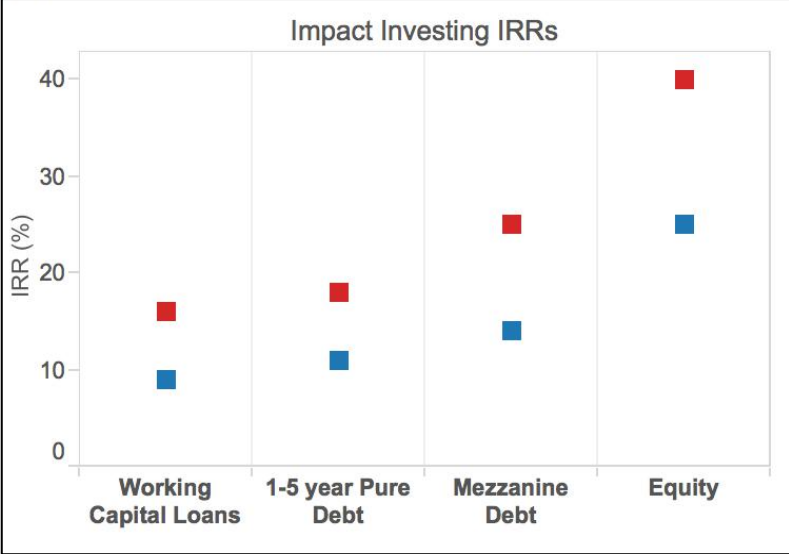
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<sup>8</sup> This strategy of layered capital could prove especially effective in Central America by bringing more traditional, non-impact oriented investors, such as a local bank, into the investment and making them the senior debt while the impact investor supplies a junior debt.

<sup>9</sup> An important aspect to consider with returns is the holding period. Impact investors focused on scaling generally operate on a longer-term time horizon for their investments. Roughly 75% of impact investors now target holding periods from 5 years to 10+ years (Kohler et al. 2013). The extended holding period is a major concern for the impact investing community. Time is the enemy of market rate returns (IRR) and expectations from sources of capital will not be met if they are at or near historic market levels.

on estimates provided by the Calvert Foundation (Calvert 2013). For each instrument a typical range of expected IRR's exists – in Figure 4 red represents the upper bound of the range and blue the lower bound. While these figures are not specific to Central America, they are a good representation of the types of IRR's that can be achieved in a developing economy.

**Figure 4: Historical IRR of Impact Investing (Source: based on data from Calvert)**



A second category of funds is referred to as Philanthropic funds, which has an average target IRR of 5%. Funds in this category are typically supported by grants and donations and can be categorized as nonprofits or venture philanthropy. The final category is the Grant-making Foundations that have no expectation of receiving any money back.

**VII. Sampling of Investors in Central America**

In order to more fully understand the scope of impact investors operating in Central America, the following section will outline a few investors that each represent a different approach to impact investing, including fund structure, financial instruments used and types of investees focused on.

Root Capital is a U.S. based non-profit lending organization that provides loans ranging from \$50,000 to \$2 million to rural small and growing businesses (typically agricultural), especially those businesses not

currently reached by commercial lenders (Root Capital 2015). Most Root Capital loans can be categorized as short-term trade credit, pre-harvest loans or long-term fixed-asset loans. Since 1999, Root Capital has disbursed more than \$740 million in credit to over 530 businesses in Africa and Latin America (Root Capital 2015). In Central America, particularly Nicaragua and Guatemala, Root Capital works closely with several agricultural fair trade associations and farmer cooperatives to provide the necessary financing to overcome the seasonality of farmer incomes while also supporting environmentally sustainable practices (Root Capital 2015).

EcoEnterprises Fund was originally launched by The Nature Conservancy but has operated as an independent investment manager since 2010. It is a for-profit investment fund that works in Central America as well as the Amazon Basin and the Northern Andes. EcoEnterprises makes for an interesting case because of the broad range of investment vehicles used, namely: quasi-equity, royalties, convertible notes, and long-term debt; all playing the role of growth capital. As the name suggests, EcoEnterprises is focused on expanding environmental sectors that prove profitable for ‘bottom of the pyramid’ communities.<sup>10</sup> These sectors can include organic agriculture, ecotourism, sustainable forestry and non-timber forest products (EcoEnterprises 2013).

Pomona Impact is an impact investment fund working in Central America as well as Mexico, Colombia and Ecuador, typically making growth capital investments between \$50,000 and \$250,000 in for-profit impact enterprises but will also consider start up funding and working capital financing (Pomona 2015). They work in a variety of sectors including artisan crafts, health, education, ecotourism, agribusiness, and renewable energy. They have a preference for using subordinated debt along with an income-sharing component but will also consider equity investments if appropriate (Pomona 2015).

Agora Partnerships is a non-profit accelerator that provides impact oriented enterprises with access to social, financial, and human capital through consulting services and high quality programming. Their mission statement is “to accelerate the success of early-stage impact entrepreneurs who share [their] community’s commitment to solving social and environmental challenges through business” (Cortes and

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<sup>10</sup> Bottom of the pyramid (BoP) generally refers to the 2 billion or more people in the world that live on \$2 a day or less.

Sorenson 2013). Since their inception, they have served over 500 businesses in Central and South America, and have created over 1000 jobs. Agora has been able to obtain more than \$15.6 million in financing for companies that have completed the accelerator program (Agora Partnerships 2015).

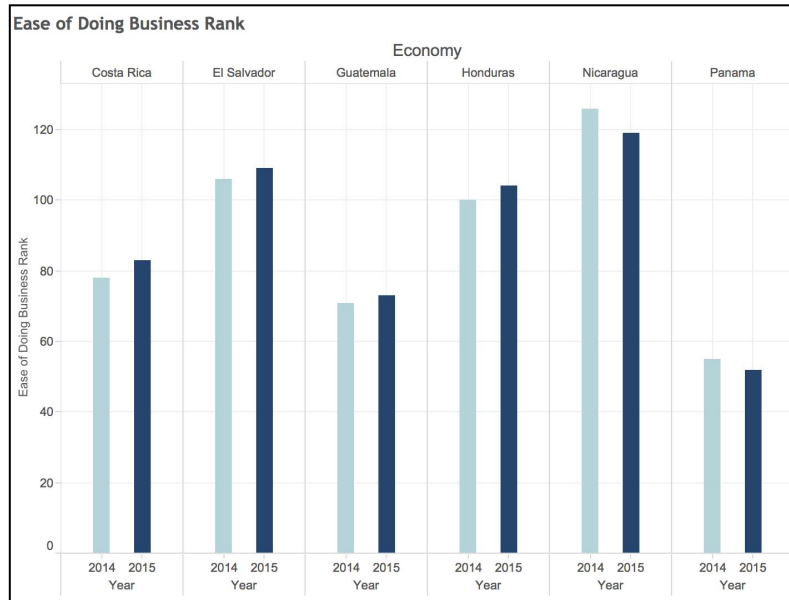
Banco Nacional de Costa Rica has a program, 'PYME Verde' which translates to the 'Green Small and Medium Enterprise' program. This program was developed to incentivize small and medium enterprises to implement investments oriented towards the prevention, control, mitigation and compensation of the negative effects to the environment from business activities, promoting more environmentally friendly mindset. The program offers differentiated interest rates and alternative Partial Guarantees of Credit for environmentally friendly enterprises (Banco Nacional 2015). This is a part of the Bank's efforts to support a vision of sustainable development and finding a balance between the three factors society depends on: economic, social and environmental (Banco Nacional 2015).

Each of the previously described entities have a unique strategy for supporting impact oriented businesses. Much of their support and capital is tailored to the type of business they are working with and the local environment being operated in.

## **VIII. Investment Pipeline in Central America**

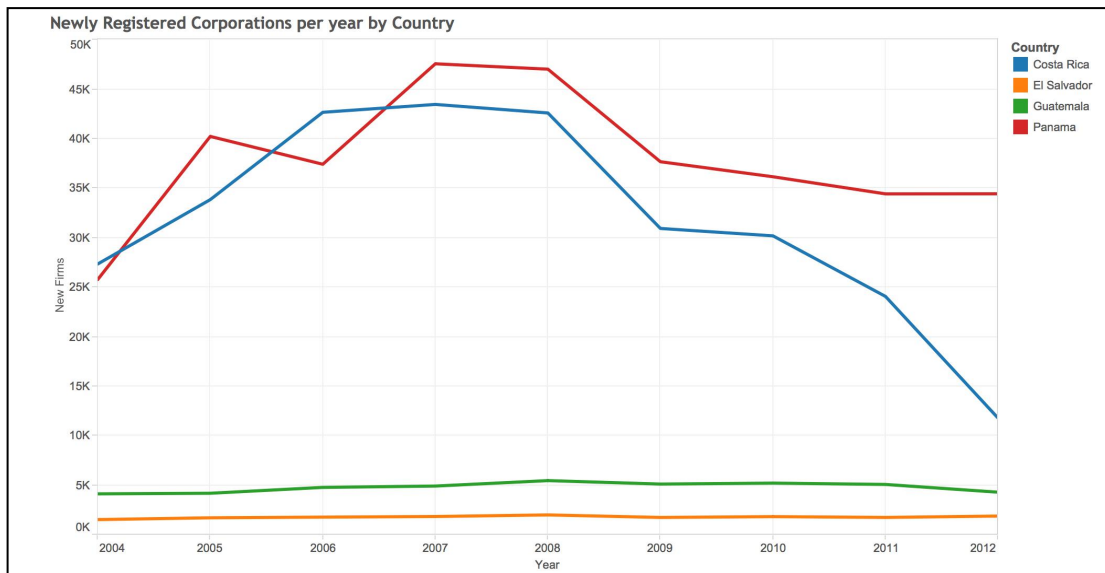
To more completely understand the impact investing sector in Central America it is important to outline the investment pipeline the aforementioned investors are working with and its potential for growth. To begin and further reiterate the range of business environments in the region, Figure 5 below shows the current year's and previous year's Ease of Doing Business Ranking in each of the countries, based on the World Bank's data. The higher the ranking, the harder it is to do business in that country. Panama is by far the easiest country to do business in, while Nicaragua is the most difficult (Doing Business 2015). These factors influence the likelihood of formally established and investment ready corporations in the country.

Figure 5: Ease of Doing Business Rank (Source: Doing Business, 2015)



To further detail the entrepreneurial ecosystem in Central America, Figure 6 shows the number of newly registered corporations in each year from 2004 – 2012 (Doing Business 2013). There is an immediately noticeable disparity between the top two countries, Costa Rica and Panama, and the bottom two, El Salvador and Guatemala. Also of note is that data for Honduras and Nicaragua does not exist. This suggests difficulty in acquiring the necessary information and likely signifies numbers more in line with El Salvador and Guatemala rather than Costa Rica and Panama.

Figure 6: Newly Registered Corporations (Source: Doing Business, 2013)



Both Figures 5 and 6 make strong cases for the need to improve the ease of doing business and with it, the entrepreneurial mindset of Central America. By improving these aspects of business culture, the pipeline for impact investors will undoubtedly improve and open the door to an increase of socially oriented businesses being launched.

### **Types of Investees in Central America**

Potential investees are primarily composed of corporations, small and medium enterprises (SMEs), social enterprises, microfinance institutions, cooperatives, and community development finance institutions (Jackson 2012). These are organizations that need access to social, financial, or human capital in order to grow their financial and/or social returns and in many cases they are stuck in what is referred to as the ‘pioneer gap’. This is essentially no man’s land in terms of finding the funding necessary to scale an enterprise. Businesses in this space may be too large for a microfinance institutions but too small for traditional private equity. To clarify and differentiate between SMEs and Social Enterprises a brief description is included below.

#### *(1) Small and Medium Enterprises (SME)*

SMEs are defined as commercially viable businesses with anywhere from around 5 to 250 employees. They have the potential for significant growth and seek growth capital between \$20,000 - \$2M (Baird et al. 2013). The challenge for these organizations is that they are usually too large for microfinance loans, or too small for traditional private equity from private sector organizations. Additionally, sometimes these organizations face very high interest rates from commercial lenders due to high country risk, and are therefore unable to grow their businesses. Investing in SMEs may have primarily economic impacts through wage increases, higher quality low cost products for consumers, higher demand for and sales of goods for suppliers, and even generation of tax revenue for the public sector – all of which can help lead to poverty reduction.

An example of a Central American SME is a tortilla factory in Honduras that received financing from the microfinance institution, Banco Popular (Bamboo Finance 2015). Thanks to this financing, Ms. Garcia,



the owner of the tortilla factory, now employs 10 people on a full time basis, making and selling 55,000 tortillas per day (Bamboo Finance 2015). She received her first loan in 2010 for 101,000 Honduran Lempiras (~\$5,000 USD) and is now on her fifth loan, worth 300,000 Honduran Lempiras (Bamboo Finance 2015). The financing provided by Banco Popular allowed Ms. Garcia to expand her operations and hire more employees when a traditional bank would be unlikely to have given her a loan. Of note, her business does not include specific social and/or environmental impact measurements as a part of the business.

Another example of an SME is Setesik, a company that creates markets for woven leaf pine artisans in rural, generally poor areas of Guatemala (Setesik 2014). Setesik aggregates products from a region and makes them available for sale around the world, thereby preserving a traditional craft while opening channels to outside markets. Incomes for leaf pine weavers from Setesik are estimated to be up to 4 times greater than what they would be otherwise (Setesik 2014).

## *(2) Social Enterprises*

The Social Enterprise Alliance (SEA) defines social enterprises as “businesses whose primary purpose is the common good, which use methods and disciplines of business and the power of the marketplace to advance their social, environmental, and human justice agendas” (SEA 2015). Thus, the term ‘social enterprise’ refers to the mission of the enterprise, while SME refers to the size of the enterprise. As a result, a company can be both a ‘social enterprise’ and an SME – they are not necessarily mutually exclusive terms. It is very important to distinguish between two types of organizations that fall under the social enterprise category: impact enterprises and social businesses.

### *(a) Impact enterprises:*

The Rockefeller Foundation defines impact enterprises as organizations that “intentionally seek growth to sustain financial viability, realize increasing social impact, and influence the broader system in which they operate.” Impact enterprises try to achieve both financial and social returns simultaneously, while investing its returns at its own discretion. They are able to engage all types of financial vehicles for growth, and can pay dividends to investors.

Examples of impact enterprises in Central America include the company Trash, which operates in Costa Rica making designer bags, wallets, purses, etc. all from plastic bags and canvas that would otherwise have ended up in the landfill. Since its inception in 2011, Trash has reached a scale such that they repurpose over 15,000 plastic bags and 500 kg of canvas on an annual basis (Trash 2015).

In Nicaragua, the company Cosecha Partners produces, processes and distributes fair and direct trade organic, non-GMO food products. Cosecha creates channels to regional and international markets for these sustainable food products and uses market mechanisms to build sustainable food systems (Cosecha 2015). Cosecha also provides resource management and agricultural training services to those farmers they work with.

Solubrite is an impact enterprise that provides safe, clean, economical lighting to rural areas in Panama and Nicaragua (Solubrite 2015). The company was created to improve the environmental, social and economic conditions in these poor rural areas without electricity through solar lamp batteries that significantly reduce the quantity of traditional batteries a family needs to purchase for lighting. On average a family may use 72 traditional batteries a year often disposing them in rivers, lakes, etc., while a single solar lamp battery will last 5 years (Solubrite 2015).

*(b) Social Business:*

Muhammad Yunus coined the term ‘social business’, defining it as “a non-loss, non-dividend company designed to address a social problem. The profits are used to expand the company’s reach and improve the products and/or services” (Jager and Sathe 2014, chapter by Martin Loffler). Social businesses are businesses whose sole focus is to solve a social problem, meaning they cannot distribute any of their returns to investors. Instead, any profit made is reinvested back into the business to promote growth, lower costs, and improve quality. The only financial return an impact investor can expect from a social business is his or her initial investment with no interest or dividends.

The company Nutrivida, launched in November 2013, is the first ‘social business’ in Central America and was founded by Gisela Sanchez.<sup>11</sup> It is designed to disrupt the poverty cycle through a product offering to help overcome malnutrition in the early cognitive development of children. As the first social business in Costa Rica and the region as a whole, there is no legal framework to support Nutrivida’s purpose<sup>12</sup> and structure and as a result it is incorporated as a traditional for-profit business (Sanchez 2015).

### *Additional Features of Potential Investees*

On top of the investee categories just outlined, there are several other aspects to a potential impact investee that an investor in Central America needs to understand. As mentioned earlier, the socioeconomic conditions can vary widely across the region. With these widely varying conditions, the motivation for creating a business can vary as well. The biggest distinction to make is whether the business was started for subsistence purposes, more specifically; the owner’s primary and possibly sole motivation is to generate an income. On the other hand, there are impact oriented businesses that are highly motivated to generate a positive social impact and where the owners do not depend as heavily on the income generated by the business’ operations. For example, a business in Honduras, such as the tortilla factory, may be created for subsistence reasons while a business in Costa Rica could be created for a specific social/environmental purpose, similar to the company Trash. The Honduran business may not have a social element, but the creation of economic activity by those living in poverty inherently helps improve social conditions when it alleviates poverty.<sup>13</sup> As a result, the impact investor in Honduras may have to look for different impact metrics than one in Costa Rica not only because the business is different but because the people starting the business are starting it for different reasons.

In close relation to the differentiation between businesses created for subsistence and those for a social/environmental mission is the concept of impact themes. An impact theme is simply the type of impact the

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<sup>11</sup> Nutrivida developed through a partnership between Florida Ice and Farm Co. and Yunus Social Business (Sanchez 2015).

<sup>12</sup> Going forward, the development of a distinct legal status could enhance the ability of social entrepreneurs to pursue impact oriented strategies which may be less profitable initially than a traditional business.

<sup>13</sup> The question then becomes, at what stage of growth should the Honduran business have to intentionally incorporate specific social/environmental elements to still be considered an impact investment?

enterprise and the investor wish to create, usually through the sector being invested in (Mudaliar and Barra 2015). For example, many impact investors focus on an impact theme of ‘access to finance’ through investments in microfinance institutions (MFI’s) and/or loans to cooperatives. Both are popular methods for providing financing to areas that would normally not have access or have very limited access. In fact, providing financial services is by far the most common form of impact investing in Central America and around the world, perhaps because the impact metrics are comparatively easy to track and understand and the business model is well established (Murphy and Schiff 2015). Other impact themes such as sustainable consumer products, access to basic services, sustainable real assets, etc., may have trackable metrics but may be more difficult to manage with less understood businesses models and thus the current appeal of the financial services sector.

Thus, access to financial services presents an opportunity to manage what is measured. This access allows for economic development to occur in those areas where incomes tend to be the lowest. In most cases, these MFI’s are providing small loans to entrepreneurs and business owners who are simply working to make a living but do not have the necessary capital to handle the upfront costs often associated with the equipment, space, animals, etc. needed to jumpstart a microenterprise.

## **IX. Expanding the Scope of Impact Investing in Central America**

Central America is a region showing great signs of potential for future impact investments, but it is clear that to be able to participate in impact investing across the region, an investor must be equipped to assess the diversity of opportunities. An investor’s scope of impact investing must expand and/or reorient itself based on the socioeconomic, political, legal and financial environment being invested in. Whether it is improving access to basic financial services or launching the latest clean technology, the potential to scale with the appropriate business model is unquestionable given the large populations in the region set to benefit from an impact oriented business as well as the ability to expand into the large neighboring markets of Mexico and Colombia.

The alternative is to instead focus on a specific impact theme, likely within a single country in order to hold political and macroeconomic conditions constant. Under this scenario many different market players

would have the opportunity to emerge, each with a specialized skill set and deep knowledge base regarding an impact theme, a local business environment, a growth strategy appropriate for investee's sector and business model, etc. With several more specialized market players, utilizing a partnership, formal or informal, could prove valuable for developing an investment pipeline as well as reducing risk.<sup>14</sup>

At this stage of the impact investment sector's growth, developing and implementing suitable impact metrics for a given impact theme will continue to be critical for the future growth of the sector. The measurement of social and environmental impact is the core element to this investment strategy and successful measurement is what differentiates this strategy from traditional investing. Once impacts can be better understood, including how they interact with other aspects of society, impact investing will no longer appear to be a less profitable form of investing, but a competitive investment strategy.

Additionally, the diversity and size of Central America make it an ideal testing ground for new and innovative impact investment strategies. Working within a smaller, sometimes partially isolated economy (for example, a district in Nicaragua) will allow for testing strategies on a small scale and failing quickly (i.e. efficiently) allowing for rapid knowledge creation that can be applied to future investment strategies. After a series of iterations throughout the region, investors will have a strong understanding of what forms of investment work, what types of businesses succeed in what environment and as a result have an expertise that can be applied elsewhere.<sup>15</sup>

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<sup>14</sup> Many investment funds create a partnership with other market players that have a complementary skill set, such as a social enterprise accelerator. This creates increased levels of collaboration allowing for each player to be more specialized in the service they provide, thus improving the efficiency and effectiveness of the impact investment. Partnerships can also come in the form of layering capital. For example, a philanthropic institution could partner with a for-profit fund, and the philanthropic institution would provide venture philanthropy and upon reaching certain objectives, the investee could then be eligible for more substantial debt or equity type investments.

<sup>15</sup> This type of scenario also allows for an in depth controlled study of the effects of impact investments on an area and how the impacts created move through the various parts of society. Such a study would be much more difficult in a larger, more dynamic economy.

## **X. Conclusion**

Impact investing represents the form of investment that recognizes the incompleteness of purely profit motivated economics and the limited role the ‘invisible hand’ can play in distributing benefits to society based purely on traditional economic decision making.<sup>16</sup> However, and perhaps most importantly, it continues to acknowledge the power of markets to generate solutions.<sup>17</sup> The field of impact investing will continue to develop as our understanding of social and environmental impacts continue to develop. This process would be accelerated through creating a successful impact investment framework implementable in a range of socioeconomic environments. Central America is a region with just such an environment and has seen significant positive advancements in the field of impact investing. The diversity of the region will require an expanded understanding and shifting mindsets to effectively pursue the full spectrum of potential impact investments.

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<sup>16</sup> We must not forget the importance of the interconnectedness of all aspects of the economy and the people that make up the economy. The idea of the ‘invisible hand’ from the free market only proves relevant and meaningful because of this interconnectedness. The irony of the metaphor is that the ‘invisible hand’ only occurs from people selfishly pursuing economic opportunity they can see (i.e. readily recognize and can take advantage of). For all the opportunities people cannot see there is no invisible hand to distribute unintended social benefits. Thus, the ‘invisible hand’ can only guide free markets as far as our current understanding of resources and their scarcity exists.

<sup>17</sup> “Perfection of means and confusion of goals seem—in my opinion—to characterize our age.” -Albert Einstein

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