

A Global Phenomenon and China's Emerging Role

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Abstract: This article offers a comprehensive examination of the present and future states of impact investing in China, an emerging domain where financial capital is strategically utilized to address societal and environmental challenges. The study commences with a historical review, outlining the global rise of impact investing and its transition within the Chinese economic framework. It meticulously differentiates between impact investing, Environmental, Social, and Governance (ESG) investing, and venture philanthropy, thereby elucidating their distinct roles and objectives. The paper then delves into the unique characteristics of the Chinese context, focusing on the early stages of the impact investing market, the cultural and legal challenges encountered, and the distinctive roles of family offices and high-net-worth individuals. It emphasizes the increasingly significant role of family offices in the Chinese impact investing arena. Additionally, the article critically assesses the current frameworks and methodologies for evaluating impact investments, discussing their limitations and the complexities involved in quantifying social and environmental impacts. Through policy recommendations, the study advocates for the strengthening of regulatory frameworks, the enhancement of standardization, and the promotion of educational initiatives to cultivate a more robust impact investing ecosystem in China. The paper concludes by recognizing the untapped potential of impact investing in China, suggesting that advancements in legal frameworks, market transparency, and public awareness could significantly propel the sector forward. This research contributes to a deeper understanding of impact investing in China, offering insights and guidelines for policymakers, investors, and scholars interested in the intersection of finance and social good.

Keywords: Impact Investing, Family Office, Philanthropy, Social enterprise, Capital for Good

1. Introduction

As the global financial landscape undergoes a profound transformation, impact investing emerges as a pivotal driver, interweaving financial returns with social and environmental betterment. This study delves into the burgeoning realm of impact investing within China's context, a nation spearheading this paradigm shift. In an era beleaguered by climate change, social inequities, and poverty, impact investing ascends as a vital instrument, leveraging capital for societal advancement.

Tracing its lineage, the integration of societal benefits in investment strategies isn't a novel concept. However, its evolution into a structured, widely acknowledged approach, particularly in China's

swiftly maturing financial market, marks a recent phenomenon. This paper commences with a global exploration of impact investing's origins, charting its growth into a movement redefining financial capital's objectives. It meticulously delineates this approach, distinguishing it from Environmental, Social, and Governance (ESG) investing and venture philanthropy, thereby establishing a clear theoretical framework essential for comprehending impact investing.

Centering on the Chinese landscape, this study examines the nascent yet swiftly evolving impact investing market. It scrutinizes the unique cultural, economic, and regulatory facets shaping this investment form in China, highlighting the attendant challenges and opportunities. Notably, it underscores the role of family offices and high-net-worth individuals in China, whose investment decisions increasingly transcend traditional financial return considerations.

This inquiry into China's impact investing terrain transcends mere financial trend analysis; it represents a broader scrutiny of how nations can intertwine economic growth with sustainable, equitable development goals. Through a detailed examination of the mechanisms, actors, and outcomes of impact investing in China, this paper aims to furnish a comprehensive overview and a critical appraisal of its role in tackling pressing global challenges. The insights proffered deepen our understanding of impact investing's feasibility, efficacy, and prospective trajectories in China, significantly enriching the academic dialogue on finance as a force for good in a complex, interconnected global milieu.

Impact investing is the use of investment by financial capital to solve and supplement social problems such as unequal primary and secondary distribution. Since the 1980s, the rise of global financial capital has been rapid, gradually surpassing productive capital and becoming one of the most important economic activities in the world. In this process, the investment experience of countries, societies and individuals has been growing, and the field of investment has expanded from the initial financial category to other fields. As a transformative force in global financial markets, it has evolved into a key instrument for advancing social and environmental well-being while also pursuing financial returns. This approach to investing not only extends traditional notions of philanthropy and corporate social responsibility, but also puts social impact at the heart of investment strategy. The China Development Brief mentions that by 2020, the Global Impact Investing Network (GIIN) estimates the market size of impact investing to be \$715 billion, while the International Finance Corporation (IFC) estimates it to be around \$2.3 trillion[1-3]. Particularly in China, this type of investment has shown great potential to address global challenges such as climate change, poverty and inequality. The purpose of this paper is to explore the current state of impact investing in China and its main channels, and how these efforts can be harmonized with global sustainability trends.

The difference between impact investing, ESG investing, venture philanthropy, etc.

Impact investing focuses on producing positive social and environmental impacts through investment; ESG investing emphasizes the importance of environmental, social and governance factors in investment decisions; venture philanthropy combines charity and investment to fund social enterprises through venture capital[4].

2. The Current State of Impact Investing in China

Within the global financial landscape, China's impact investing market remains in its early stages, with its industry chain not yet fully matured. The main challenges it faces include a shortage of skilled personnel, insufficient government support, and a scarcity of high-quality investment opportunities[1]. For instance, legal barriers in China's charity and trust laws restrict the application of charitable trusts in impact investing. Additionally, there is a lack of influential social organizations and programs in China, posing challenges to the development of impact investing. Most foundations and investors tend to adopt a stricter definition of impact investing, reserving skepticism for broader interpretations. They argue that merely profiting from the stock market or investing in mature-stage companies

alongside ordinary investors, expecting market returns, does not genuinely produce social impact, particularly when considering the additional value that capital brings. This narrower definition aligns more closely with China's cultural context and societal perceptions, helping to preserve impact investing as an investment strategy aimed at achieving positive social outcomes[2].

In an interview with the 21st Century Business Herald, Lin Yigu, Vice President of the China Impact Investing Network, noted that the concept of Impact Investing was initially proposed by the Rockefeller Foundation in the United States in 2007. Its definition refers to investment activities that, while seeking financial returns, actively pursue measurable social and environmental benefits[5].

Family offices and high-net-worth individuals play a crucial role in impact investing. According to last year's report from the Global Impact Investing Network (GIIN), even though the proportion of impact investments by family offices is not particularly high compared to fund managers (4% last year), this percentage only includes direct investments and does not cover investments in fund managers. However, many family offices or family businesses are actually practicing impact investing in the role of Limited Partners (LPs)[5].

Compared to the EU and North America, family offices in Asia are still in their initial stages, developing relatively slowly. Despite the pace of wealth accumulation in Asia being much faster than in Europe and the United States, wealthy Asian families generally have a lower acceptance of the family office concept[6]. Compared with other regions, family wealth in Asia is a more opaque subject. Privacy is regarded as crucial in Asia, so wealthy families place great emphasis on the security and confidentiality of wealth [7-8]. It is common for family leaders to distribute their assets across different institutions and financial groups, making it difficult for any institution or member to understand the real scale and scope of family wealth. They tend to personally entrust their material wealth to large financial institutions or wealth management institutions, paying less attention to family businesses, family spiritual and cultural heritage, and family governance. Most family offices are still part of the family business, with family interests and business involvement usually intertwined. Rarely are family businesses found to operate independently of their owning family. The decision-making mechanism in Asian family offices is typically dominated by family members, with few non-family members participating. However, due to the rapid accumulation of wealth in recent years, the asset management scale of family offices in some emerging regions is improving, and many are beginning to invest in the market[9].

3. Case Studies

In 2011, China began experimenting with combining philanthropy and financial capital to explore solutions to social problems. However, the path of impact investing in China has not been a smooth one. Chinese charitable organizations and programs have been frequently blamed in the process, such as the scandalous revelation of the Renji Hospital Charitable Foundation, which revealed misuse of funds, use of donations for commercial projects or high salaries. This series of events has made the combination of charity and business a highly controversial topic, and has even been seen as an umbrella for some unscrupulous activities, bringing heavy resistance to the development of impact investing in China. However, after a series of crises around the world, such as the New Crown Epidemic and global warming, people have been forced to pay more attention to social issues. Against this backdrop, impact investing has gradually attracted widespread attention as a tool for solving social problems through financial capital. As society continues to focus on sustainable development and social responsibility, some organizations and companies are beginning to re-examine their business models and explore more socially valuable ways of doing business. We've also seen a recent surge in enthusiasm from Chinese investors. In the coming twenty years, it's projected that around 3.4 trillion dollars in wealth will transition to a new generation of affluent families. affluent families.

A significant portion of these younger, wealthy individuals are driven by a desire to create meaningful impact[3].

From the financial centers of Shanghai and Beijing to the social entrepreneurs in Shenzhen, The Rockefeller Foundation brings its expertise in innovative finance to China, supporting the nation's own development goals as well as the global Sustainable Development Goals (SDGs) agreed upon by every country in 2015. China's unprecedented wealth creation, emerging philanthropic regulatory structures, and a population of 1.4 billion present an exciting opportunity to collaborate with both the Chinese private and public sectors in supporting the growth of impact investing[8].

3.1. Ehong Impact Capital

Ehong Impact Capital has demonstrated significant involvement in the fields of agriculture, healthcare, and environmental protection. Their investment in Lv Kang Medicare has effectively enhanced the quality of healthcare facilities and increased the equity investment value of Ehong. This case study exemplifies how investments in key areas can generate substantial social and environmental benefits while also yielding economic returns.

3.2. Case Study: Chongho Bridge

Chongho Bridge, funded by the Rise Fund, focuses on providing assistance in the agricultural sector through microfinance services. The approach of this organization highlights the positive social impact that can be achieved through strategic financial support in agriculture, a sector vital for sustainable development[1].

Ehong concentrates on healthcare and environmental protection, while Chongho Bridge focuses on agricultural assistance. However, both approaches underscore the versatility and wide scope of impact investing in meeting the diverse needs of Chinese society. Collectively, these case studies demonstrate the effectiveness of impact investing in promoting sustainable development and social welfare in China.

In China, family offices, individuals, family philanthropic foundations, leading corporations and government departments are the main players in impact investing. Family offices in particular have emerged as a new source of dynamism in the Chinese market, not only managing the wealth of UHNW individuals or families, but also increasingly engaging in impact investing, driven by a sense of social responsibility. As UHNWIs change their wealth goals from wealth seeking to wealth preservation after completing a certain level of wealth accumulation, many entrepreneurs choose to transform their family business into a family office, especially those in traditional industries, which are suffering from the New Crown Epidemic as well as the domestic political environment, and are unable to obtain a stable and sustainable cash flow. Making the transition to a family office can help the family to be evergreen. In the wealth preservation phase, many key family players are also more inclined to make impact investments to demonstrate personal and family social responsibility and thereby enhance the reputation of the individual or the family. As a result, family offices are a very important body for impact investing. The future market for family offices in China is expected to exceed one trillion dollars, and impact investing is also expected to grow rapidly in China.

4. Quantification and Evaluation Systems in Impact Investing

In addition to people's reluctance to capitalize on the good, there are also some difficulties in evaluating impact investing itself. The impact of impact investing is not 100% quantifiable, which makes it extremely difficult to evaluate investment results. Currently, widely used tools to assess the value of impact investing include the Impact Reporting and Investment Standards (IRIS) developed by the Global Impact Investing Network (GIIN), which provides a common set of metrics to measure the

value of impact investing. The B Lab Impact Assessment Tool, developed by B Lab, helps companies assess their overall impact on employees, communities, the environment, and customers; this tool is widely used to assess and improve the social and environmental performance of organizations. Social Return on Investment (SROI) is a principles-based framework for measuring and financializing social value. SROI provides a way to quantify the value of social and environmental impact and translate it into financial value. While the impact investing assessment tools mentioned above provide important frameworks and indicators to measure social and environmental impact, they share some common shortcomings and challenges:

- 1 Standardization and consistency issues: different assessment tools and frameworks may use different methodologies and indicators, which leads to difficulties in cross-project or cross-investment comparisons. This lack of standardization limits the consistency and comparability of results.
- 2 Data availability and quality: High-quality, relevant and accurate data are essential for effective assessments. In practice, however, obtaining such data is often challenging, especially in environments with limited resources or inadequate data collection systems.
- 3 Subjectivity and interpretation of results: Some assessment methods, such as social return on investment (SROI), involve quantifying social and environmental impacts into financial values, a process that can be subjective and the interpretation of results may vary from user to user.
- 4 Implementation costs and complexity: A comprehensive impact assessment can require a significant investment of time and resources. For some small businesses or start-ups, this can be a significant burden.
- 5 Over-reliance on quantitative indicators: while quantitative data is key to assessing impacts, over-reliance on such data may overlook important impacts that are difficult to quantify, such as social change, policy changes, etc.
- 6 Difficulty in assessing long-term impacts: many social and environmental impacts take a long time to become apparent, and current assessment tools may be insufficient.

Insufficient cultural and regional sensitivity: Globalized assessment tools may not adequately take into account region-specific social and cultural contexts, resulting in findings that may not be fully applicable to specific contexts[10].

Despite challenges such as issues of standardization and consistency, data availability and quality, subjectivity and interpretation of results, and implementation costs and complexity, impact investing assessment tools, such as IRIS, the B Lab Impact Assessment Tool, and SROI, provide important frameworks and indicators for measuring social and environmental impact.

5. Policy Recommendations

The paper suggests strengthen regulatory frameworks and standardization: Establish and promote uniform impact investing metrics to increase the transparency of the industry, better control and regulate the flow of funds, and prevent money laundering and corruption. Encourage more impact investing by offering tax breaks and other financial incentives to businesses that demonstrate significant social or environmental impact.

Mitigate investor risk through government guarantees or risk-sharing mechanisms. Encourage governments to partner with the private sector to co-finance social and environmental programs to promote impact investing.

Establish impact investment government funds and platforms to guide and scale up impact investments. Add courses related to sustainable finance and impact investing to higher education institutions and vocational training to upgrade the professional knowledge and skills of relevant personnel.

Encourage the development of social enterprises by providing start-up capital, incubator support and technical guidance. Actively cooperate with other countries and international organizations to share best practices and learn from international experience. Promote China's impact investing programs and achievements globally.

Social enterprise is also one of the most important means of achieving impact investment. Social enterprise is a model that achieves social goals through business strategies, thereby achieving social goals more broadly and deeply. However, the current public understanding of social enterprises is still relatively superficial. Many people equate social enterprises with welfare organizations, such as organizations that employ people with disabilities or are not for profit. But in fact, social enterprises also pursue profits and have investors and investment exit mechanisms. They are established based on the interests of stakeholders, represent the common interests of these stakeholders, and have clear social goals, such as environmental protection goals, ethical value goals, etc. Additionally, they are for-profit entities, not charitable organizations. Therefore, in the process of advocating the third distribution, whether the focus should be shifted to social enterprises to better promote the institutional construction and development of national social enterprises is an issue worthy of attention. Second, impact investing. In the third distribution, impact investment and venture philanthropy may become important ways for entrepreneurs to participate. Third, charity. There are several appropriate ways for enterprises to participate in charity: for example, setting up a foundation to make donations, establishing a non-profit organization to make donations, setting up a special fund to make donations, or setting up a charitable trust to implement personalized charity projects in the long term[4].

For family offices to effectively engage in impact investing, they first need to recognize that the traditional approach of solely maximizing financial returns is no longer sufficient. Focusing on impact and sustainability-related investments represents the future direction. Therefore, when family businesses or family offices invest, they should add a third dimension - impact - to the traditional two dimensions of risk and return. Secondly, as many businesses seek a second growth curve, impact investing could be one of the pathways. In the long term, it could generate substantial financial value, such as investing early and holding long-term in the next "Tesla" that creates environmental or social value. Thirdly, from a practical standpoint, it's crucial to set investment goals, define an impact strategy, and continue to learn and adapt throughout the investment process, finding a path that suits one's needs. Fourthly, there should be an upgrade in asset allocation thinking, such as employing a "holistic impact portfolio" strategy for overall capital allocation. During the investment process, continually measure and manage the social and environmental value generated by the investments to refine the strategy and, in turn, generate better financial and social returns. At the outset, it's advisable to establish a few key indicators based on impact goals and iterate during the process, rather than setting up a very complex indicator system from the start[5].

6. Conclusion

To sum up, impact investing as an effective means to address social and environmental issues is still in its infancy in China, but has great potential. By improving the legal framework, increasing market transparency and raising public awareness to promote the role of family offices and social enterprises in impact investing, China is expected to make significant progress in impact investing.

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