Next Generation Fund: One Year Review

The pooled vehicle of our impact investment fund launched in late August 2020. The idea behind this strategy was to allocate capital towards those businesses helping drive immediate and substantial positive social outcomes in the developing countries we cover. We do not seek 'ESG best performers'; but instead those companies directly targeting the largest and most urgent areas of need. We believe that identifying business models which can effectively and efficiently scale over the long-term is the surest path to enduring and expanding impact. These businesses have the potential to reach tens of millions of underserved customers, but often operate in relatively shallow financial markets, and stand to benefit from the provision of 'patient capital' which can help them expand sustainably, rather than over-prioritise short-term profitability.

We have initially chosen six impact themes, comparable to UN Sustainable Development Goals, under which we believe private enterprise has the most potential to drive positive change in a manner which can also be rewarding over the long-term to shareholders. Our portfolio of companies already impacts a total of 390 million people (720,000 adjusted for our ownership stake at the strategy level), or 14 million expressed as a per company average. Our forecasts suggest they will grow at 15% on the top line over the coming five years; these are overwhelmingly volume-driven businesses committed to improving access and affordability, such that this revenue CAGR figure could also be assumed to be a reasonable proxy for growth in 'Reach'.[2]

The single biggest mistake we have made so far – our ownership of New Oriental in the Chinese education space – could have been avoided had we been more demanding in our focus on affordability (and thus on business models targeting maximum 'Reach' and 'Criticality'). The after-school tuition industry's failure to restrain pricing was, after all, a key factor in its sudden downfall.

There are of course no perfectly positive businesses, and all economic activity carries with it some form of negative impact and ESG risk. But optimising for impact could be argued to be a good way of improving financial resilience. COVID has added more weight to this case. The vast majority of our holdings have thrived over the last 18 months, for example by addressing healthcare shortfalls which were brought into sharp focus by the pandemic; by providing everyday digital access to financial services crucial to keeping the economy going; and by helping developing countries with both climate change mitigation and the development of renewable energy. Needless to say, none of these problems are anywhere near solved, and solutions businesses have the potential to benefit both from the structurally higher growth of emerging economies, but also the necessary tilt towards these sectors in the years to come.

Though we are encouraged by fund performance, now 22% since launch, we prefer to focus on the vast runway ahead for our companies, should they stick to volume, affordability and accessibility-driven strategies. While for many of our businesses this means targeting customers firmly at the base of the global income pyramid, this is not always the case. In the Financial Inclusion segment, for example, the most compelling opportunities are often still in basic financial services offered by telcos such as Safaricom and MTN Ghana; whereas in somewhat higher income countries such as Brazil, the most 'critical' market segments can be found in basic banking services for small businesses, offered by companies like PagSeguro.

[2] Arisaig Partners, Bloomberg, end September 2021. These are future forecasts and are no guarantee of future performance.