IMPACT INVESTING: WHY DOES IT MATTER FOR MALAYSIA?

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The conventional thinking is that markets will naturally determine optimal outcomes. The free market is seen as maximizing efficiency, with negative externalities regarded as inevitable byproducts that can be mitigated through risk management. However, this belief is increasingly questioned in light of global challenges such as climate change, inequality, and rising geopolitical conflicts. These issues are highlighting the limitations of market solutions in addressing complex societal problems as market. Thus, there is a growing recognition worldwide that intervention mechanisms are essential for bridging gaps in economic outcomes and addressing these pressing issues.

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Malaysia is not exempt from the multitude of environmental and social challenges facing many nations today. Beyond frequent flooding, the country contends with various pressing environmental concerns, including deforestation, soil erosion, and the loss of numerous flora and fauna species. Additionally, the rising cost of living poses a persistent and significant challenge, particularly for lower- and middle-income groups, creating a long-term issue for government policymakers. As in many other countries, addressing these complex problems necessitates a strong partnership between the public and private sectors, as the government alone cannot fully resolve these urgent issues.

In recent years, numerous concepts and acronyms have emerged to influence the market and reshape investment decision-making processes. Terms such as Sustainable Responsible Investment (SRI), Environmental, Social, and Governance (ESG), and, more recently, impact investing, have been introduced to clarify priorities for all stakeholders. This focus is becoming increasingly significant, especially as many governments, including Malaysia, face fiscal constraints that limit their ability to invest in all areas that matter to the public. Consequently, adopting impact investing presents a strategic opportunity to engage the market in supporting environmental and societal advancement by encouraging investments that prioritize these objectives. The recent budget presentation proves the concern of the government not just to embrace this concept but make it as the central to its policymaking process.

Impact investing is a concept with diverse interpretations but a unified objective. According to the Global Impact Investing Network (GIIN), impact investing involves making investments that generate measurable social and environmental benefits alongside financial returns. Alternatively, it can be described as an investment approach that seeks to achieve social or environmental impact in addition to financial returns, although these returns may not always align with market rates. Distinct from traditional socially responsible investing (SRI), which focuses on excluding harmful practices, impact investing actively aims to create positive outcomes while also pursuing financial gains (GIIN, 2023; Trelstad, 2016). Consequently, the lines between Socially Responsible Investing (SRI) and impact investing are becoming increasingly blurred as investors aim not just to avoid harm but to generate positive social and environmental outcomes (Trelstad, 2016).

Impact investors typically fall into two categories: impact-first investors, who prioritize social or environmental outcomes and are willing to accept lower financial returns, and financial-first investors, who prioritize financial returns but also seek positive social or environmental impact (Rangan et al., 2011). The global market for impact investing, estimated at USD 3 trillion in 2023, is anticipated to grow at a compound annual growth rate of 10%, reaching USD 7.78 trillion by 2033 (The Brainy Insights, 2024). Market trends reveal growth in social impact bonds and the mainstreaming of impact investing, with large institutions moving into this space, shifting it from niche to mainstream finance. Wealthy families, private equity funds, and private offices have played a significant role by seeking to invest in solutions that address global challenges like climate change and poverty. Also, private banks, responding to the demands of clients looking for alternatives to traditional investments and pure philanthropy, have also contributed to this trend.

Although the concept of impact investing is rooted in positive intentions, significant challenges remain in accurately assessing social and environmental impacts compared to financial metrics. A key issue lies in distinguishing between intentional impacts, which are integral to a business's strategic goals, and incidental impacts, which arise as unintended consequences. Also, impact investing faces risks that could impede its growth. Economic downturns, for example, might dampen investor enthusiasm and reduce the allocation of funds to impact-focused ventures. Furthermore, the inherent challenges in attaining social and environmental objectives may render the process overly complex or unprofitable, potentially hindering sustained progress. The risk of diluted impact standards presents an additional threat, as this could reduce impact investing to a superficial exercise aimed more at fostering a sense of ethical satisfaction than at achieving tangible results. Also, a notable gap between investor expectations and actual outcomes could provoke a backlash, undermining the sector’s credibility and diminishing stakeholder trust.

Despite various challenges, numerous countries, including Malaysia, are making substantial progress in adopting impact investment strategies. This approach is essential for addressing a range of pressing issues and challenges within the nation. Effective impact investing requires a targeted approach, a growing emphasis on innovation within the field to ensure successful outcomes, and strong leadership to fulfill Malaysia's aspiration of achieving developed nation status. The active participation of entities such as Khazanah Nasional, Kumpulan Wang Amanah Persaraan (KWAP), and other government-linked corporations (GLCs) has significantly enhanced the credibility and momentum of impact investing initiatives. A deeper integration of Islamic economic and financial principles, particularly those aligned with social justice, can further elevate Malaysia on the global stage, showcasing a distinctive economic model that benefits the broader population rather than exclusively serving the elite. As Malaysia continues to aspire to be a positive role model, the time is ripe to demonstrate that impact investing can be an effective tool for national development.

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