The Role of Impact Investment Through a Responsible Investment Approach an Achieve Sustainable Investment

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Abstract. To achieve environmental justice, collective awareness must be fully affirmed and acknowledged. If environmental issues are ignored, this can trigger a multidimensional crisis such as a decrease in environmental quality and an increase in socio-economic inequality. Article 33 paragraph (4) of the 1945 Constitution of the Republic of Indonesia clearly shows the need for environmental protection and the principle of sustainability in managing the national economy. One form of environmental protection and management to support economic development is through Impact Investment with a Responsible Investing approach that takes into account the principles of ESG (Environment, Social and Governance) which supports sustainable investment (Sustainable Investment). Where in this study uses empirical research methods, which are interpreted as sociological legal research or legal research that examines real law and facts in accordance with social phenomena that are faced/arising in the surrounding community, especially the consequences arising from sustainable investment. Therefore, it is important to ensure fairness and legal certainty in green investment because an ideal legal construction will encourage people to switch to responsible and sustainable long-term investment.

Keywords: ESG; Impact Investments; Responsible Investing; Sustainable Investment

1 Introduction

The realization of social welfare can, of course, be measured at the level of national economic Development, where economic Development itself will have a significant influence on the social order or can be said to be capable of causing a domino effect. This aligns with the view of Satjipto Rahardjo, who stated that "Development is not a piecemeal change. Even if, for example, we can point to industrialization as the essence of the change, it is ultimately not just a case of a quantitative increase in the number of industries. This industrialization also invites qualitative changes associated with the structure of people's lives." This explains that changes in the economy will significantly influence the entire structure of society, so the readiness of qualified human resources and natural resources must accompany it.[1]

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The essence is that in implementing economic development itself it must run sustainably (Sustainable Development) with other fields so that balance is created. Economic development itself is one of the efforts to create prosperity for society, where this is also enshrined in the 1945 Constitution and in terms of achieving national welfare goals, of course it can be done through the role of society in balanced economic development, both in the social and environmental aspects that already exist in Preamble to the 1945 Constitution of the Republic of Indonesia, fourth paragraph[2].

The success of economic development, of course, always follows existing developments, where one of the instruments that have a significant influence on economic development activities is Investment. Investment itself is considered one of the factors that has a significant influence on economic development; this is also confirmed in the Theory of Savings and Investment by Harrod-Domar, who explains that Investment has two (2) essential roles in influencing the economy, including First, Investment itself has a very beneficial relationship with a country's income, where the higher the investment activities carried out, the higher the state's income will be. It will increase further. Second, Investment itself is considered capable of increasing economic production capacity through increasing the stock of capital, where the formation of capital itself can increase demand for the entire community so that Investment can influence the value of supply and demand in a country. Harrod-Domar's theory itself emphasizes the importance of Investment in terms of improving and financing infrastructure and the state's goals in achieving the welfare of its people.[3]

Green investment, or sustainable investment, has experienced significant growth in recent years. In capital markets, sustainable investing has become one of the fastest-growing types of investment, especially in developed countries worldwide. More than 2,400 financial asset managers and owners have committed to following the UN Principles for Responsible Investment (PRI), with total managed funds reaching 86 trillion US dollars. According to the latest survey by the Global Sustainable Investment Alliance (GSIA), sustainable investment assets in developed countries have increased to 30.7 trillion US dollars.[4]

Sustainable investment is an effort to realize investments that prioritize ESG factors to maintain economic sustainability and life in society. The focus of this investment is, of course, on realizing investments that do not harm the environment and society by prioritizing companies that have the principle of protecting the environment and providing a positive impact on people's lives. In this investment strategy, the sustainability of the economy and life on earth is considered by considering ESG (environmental, social and good governance) factors. Investments are only made in companies that do not harm the environment and even those that have a positive impact. Although a high CSR score can show a company's concern for the environment and society, it is not enough. Sustainable investing also considers social aspects and good governance, and investors tend to choose investments that take these factors into account rather than just paying attention to the environment. Sustainable investing is gaining popularity due to increasing awareness of environmental issues such as climate change and a growing number of investment products that focus on the environment.

The ESG approach to sustainable investing is currently the most significant and fastest-growing component in global capital markets. It is predicted that soon, all fund managers worldwide will consider ESG in their investment decisions, especially in Europe. According to a Deloitte report in February 2020, in the next five years, ESG will account for half of the total investment funds under management in the US. In Indonesia, the SRI KEHATI index was considered a pioneer of ESG investment in the capital market in 2009, which combines ESG exclusion and integration methods. Currently, various investment managers have launched ESG-based mutual funds that refer to the SRI KEHATI index, which has increased 10-fold to around IDR 2 trillion. ESG-based investments are not only made for reasons of environmental and community concern but also to improve opportunities and risk management in investors' portfolios. Studies and research show that ESG-based investments can provide better performance.[5]

In ensuring human sustainability and welfare, it is necessary to support a sustainable nature; however, currently, lifestyle, production and consumption patterns are not sustainable. Therefore, this investment needs to support a transformation that leads to sustainable development that obtains profits, the interests of society and sustainable development where this is in the interests of society and the environment, closely related to humans. Apart from that, investment in the financial sector also has a vital role in ensuring sustainable principles by creating new norms in finance and investment in the future. Therefore, Indonesia needs to prepare and join this movement so that it is included and included so that the country's development strategy can be maintained.

Sustainable investing, including impact investing such as ESG, continues to grow worldwide. According to the latest survey from the Global Impact Investing Network (GIIN) in April 2019, impact investment managed funds reached 502 billion US dollars. Impact investing falls into this category and also includes the issuance of green bonds. The latest data from the Climate Bond Initiative (CBI) in March 2020 shows that green bond issuance reached 805 billion US dollars.

Several venture capital and philanthropic investors in Indonesia have shown interest in startups that have business models with environmental and social impacts. Currently, investors who specifically focus on impact investment are also starting to grow in Indonesia, although still on a relatively small scale. One of these is that the Indonesian government introduced green sukuk in 2018 to encourage green bonds, and the KEHATI Foundation actively promotes investments that have a positive impact on the environment and society.

Currently, only a few large companies listed on stock exchanges are making specific and significant efforts to achieve a positive environmental and social impact. Therefore, impact investments are often made in small companies, including startups. However, green bonds can be considered an impact investment because the funds raised from green bonds are used to fund projects or businesses that have a positive impact on the environment. ESG investments are usually made by investment managers at companies listed on stock exchanges, while impact investments are often made by venture capital or private equity firms. However, institutional or individual investors can also be investors in ESG and impact investments. So, using the background explained above, of course, this article will examine the role of impact investment through the ESG (Environment et al.) approach in achieving sustainable investment.

2 Method

The approach used in the research is qualitative, according to the views of Bogdan and Taylor, who explain that a qualitative approach is an approach with procedures in a written or oral form, which then produces descriptive data in the form of behaviour observed both verbally and in writing in society. So, this research focuses more on a qualitative approach, describing or analyzing facts in the field through written or verbal objects in a field observation following existing facts.

This research uses empirical research under the views of Abdulkadir Muhammad, who explains the focus of legal research studies, one of which is empirical legal research, which is defined as sociological, legal research or legal research that examines fundamental law and facts under the social phenomena faced/arising in surrounding community order.

So, referring to empirical research methods that focus on legal realities that occur in society, this research examines the role of impact investment through the ESG (Environment et al.) approach in achieving sustainable investment and describing what happens in a society to obtain relevant facts.

3 Results and Discussion

3.1. Impact Investing at a Glance

Impact investing refers to investments made in companies, organizations, or funds to create a measurable and beneficial social or environmental impact other than financial gain. In its essence, impact investing involves aligning investors' values and beliefs with allocating capital to address social and environmental issues[6].

Impact investors actively seek opportunities to invest their capital in businesses, non-profit organizations and funds in sectors such as renewable energy, housing, healthcare, education, microfinance and sustainable agriculture. Development financial institutions, pension funds, and endowments are examples of institutional investors that have played an essential role in the development of impact investing in North America and Europe. In fact, under the leadership of Pope Francis, the Catholic Church is also increasingly interested in investing in impact investments. There are various types of investment instruments and vehicles available in impact investing. These investments generally offer financial returns that go hand in hand with awareness of environmental impacts. Industries that are often targeted for investment are health, education, renewable energy and agriculture. Typically, investments are made in developing countries and aimed at vulnerable groups, such as women and small and medium enterprises (SMEs). However, there are also large companies that focus on social responsibility and commitment to the community and environment that qualify for this investment scheme. There are two general approaches to impact investing, namely the environmental, social and governance (ESG) approach and the social responsibility (CSR) approach.[7]

Impact investing can be done in various asset types, such as private equity/venture, debt, and fixed income. Impact investing can be made in emerging or developed markets and, depending on the investor's objectives, can target a range of price returns from below market to above market. Impact investing applies standards emphasizing a company's social awareness in applying ethical criteria in its operations. The criteria used by impact investments aim to select potential investment recipients based on their awareness of three aspects: environment, social responsibility and governance. This criterion considers how the company protects the environment, ensures the welfare of employees and society, and leadership factors. Usually, these criteria are rigid, so companies can only pass some. As a result, investors need to make further considerations about which aspects are most important to them. However, this approach has several points that need to be criticized. One of them is that existing criteria often hinder a company's performance. Although ethical, sometimes a value can conflict with a company's productivity.

Companies that are labelled as bad may have good performance. This is detrimental to investors who lose the opportunity to profit from their investments. Therefore, a new approach has emerged in impact investing.

History records that regulation, and to a lesser extent, philanthropy, have attempted to limit the negative social impacts (undesirable impacts or externalities) of business activities. However, there is a history of individual investors using socially responsible investing to express their values, with this investment behaviour typically avoiding investing in certain companies or activities with adverse effects. At precisely the same time, approaches such as pollution prevention, corporate social responsibility, and the triple bottom line began to become ways to measure non-financial impacts, both inside and outside the company. In 2000, Baruch Lev of NYU's Stern School of Business discussed intangible assets in a book of the same name, which discussed the non-financial impact of corporate production. Finally, around 2007, the term "impact investing" emerged. Measuring social and environmental performance with the same level of rigour as measuring financial performance is becoming an essential component of impact investing.[8]

Since 2007, Impact Investing has been introduced, but in Indonesia, this investment concept still needs to be popular among the public. Impact Investing offers various benefits that can motivate investors to invest using this method. Impact Investment provides opportunities for anyone to invest, both individuals and institutions. This investment is aimed at those who have an interest in solving problems around the environment. Additionally, institutional and family foundations can also use more considerable assets to achieve their social goals. Impact Investing also provides evidence of financial viability for governments and the development of financial institutions.

In the last five years, the number of funds involved in impact investing has experienced rapid growth. In 2009, a report from Monitor Group estimated that the impact investment industry's assets could grow from US$50 billion to US$500 billion in the next decade. These funds can be invested through various investment instruments, such as equity, debt, tangible assets and loan collateral. The growth of the impact investing market is due, in part, to criticism of traditional philanthropy and international development as unsustainable and driven by donor desires.[8]

Although impact investing is still a tiny market compared to the global equity market, estimated at US$61 trillion in 2015, impact investors currently manage US$114 billion in assets, primarily allocated to the microfinance, energy, housing and financial services sectors. Many development finance institutions can also be considered impact investors because they allocate a portion of their portfolio to investments that provide financial, social, or environmental benefits. Impact investing differs from crowdfunding sites such as Indiegogo or Kickstarter. It typically involves debt or equity investments above US$1,000, with a more extended payback period than typical venture capital and without an exit strategy such as an IPO or buyout in the non-profit sector. Organizations that receive impact investment capital may be established as for-profit corporations, non-profits, benefit corporations, low-profit limited liability companies (L3Cs), community benefit corporations, or other designations that vary by country. In Europe, it is usually known as a “social enterprise”. Some of the leading activists in this market are Impax Asset Management Group, which is based in the UK and specializes in environmental impact investing; Sarasin and Partners, which has a history of pressuring investment companies on sustainability issues; and Triodos Investment Management, which is a Netherlands based manager which focuses on issues -sustainability issues. According to consulting firm McKinsey, India is becoming a top geography for impact investors, with more than US$1.1 billion invested in 2016.[9]

3.2. The Role of Impact Investment Through the ESG (Environment, Social and Governance) Approach In Achieving Sustainable Investment

Based on a report from the Central Statistics Agency (BPS), the Indonesian economy experienced an increase of 5.05% according to Gross Domestic Product (GDP). In 2020, the World Bank stated that Indonesia had become an upper middle-income country based on increasing GNP. However, rapid economic growth also impacts the surrounding environment, such as forest and land fires, due to the expansion of oil palm plantations in Kalimantan and Sumatra. The government has issued several regulations, both preventive and repressive, to overcome emerging environmental impacts, but the implementation of regulations still needs to be improved. To achieve sustainable development, Indonesia must adopt sustainable Development Goals (SDGs).

In May 2022, the Ministry of Investment/BKPM released a draft Sustainable Investment Guide, which aims to provide direction for business actors, investors and the government in encouraging sustainable investment. This guide defines sustainable investment as an investment that considers environmental, social and governance (ESG) factors in the selection and management of an investment portfolio. At the international level, this approach is known as responsible investing.[10]

Responsible investing is implemented by integrating ESG factors into the investment decision-making and process. ESG factors cover a wide range of issues that are not typically covered in financial analysis but which have significant financial implications. Environmental factors or environment (E) include climate change, greenhouse gas emissions, resource depletion, water and energy crises, waste and waste, pollution, and deforestation. Social factors (S) include issues of human rights, modern slavery, child labour, working environmental conditions, the surrounding community, and industrial relations with employees. Governance factors (G) include bribery and corruption, executive salaries, structure and diversity of commissioners and directors, political donations and lobbying, tax strategies, and audit and risk management systems. Responsible investing is becoming increasingly important as the financial industry, and academics have concluded that ESG factors can impact investment risks and returns. Additionally, clients and beneficiaries are increasingly demanding transparency in the management of their investments. This is exacerbated by the emergence of various regulations and guidelines that require investors to consider ESG factors as part of their fiduciary obligations towards clients or beneficiaries.

Investments made in other countries to support business not only have an impact on the economy but also on social and environmental aspects in the country where the investment is made. According to the Global Impact Investing Network (GIIN), impact investing increased from 4.3 billion USD in 2011 to 502 billion USD in 2018 and is expected to reach 1 trillion USD in 2020. Impact investing does not only focus on financial returns but also the resulting social and environmental impacts. In Indonesia, investment increased by 8% during the global pandemic, with domestic investment (PMDN) making the most significant contribution at 53% of total investment. This investment concept provides financial returns and social and environmental impacts that can be measured and evaluated, which are two requirements for impact investing. The social impact resulting from impact investing in Indonesia includes job creation, improving health, education, and more.[11]

At the end of 2020, Angel Investment Network Indonesia (ANGIN) reported high interest in impact investing in Indonesia, both from new investors and the younger generation. Apart from that, many venture capital companies are also involved in achieving the UN's sustainable development goals in Indonesia. The agricultural sector, waste management, gender-based investment (gender lens investment), and MSMEs are listed as sectors that receive impact investment. According to East Ventures, impact investing is a unique opportunity that is here to stay in the future.

Investment can have an impact if it is carried out in another country to support a business that not only has an economic impact but also has a social and environmental impact in the country where the business takes place. According to a Global Impact Investing Network (GIIN) study, impact investing increased from USD 4.3 billion in 2011 to USD 502 billion in 2018 and is expected to reach USD 1 trillion in 2020. Traditional investing focuses only on financial returns, while impact investing emphasizes potential financial benefits as well as potential social and environmental benefits. In Indonesia, investment increased by 8% despite the global pandemic, according to the Investment Coordinating Board (BKPM), with the most significant increase coming from domestic investment, which accounted for 53% of total investment. This investment concept also provides returns on financial, social, and environmental impacts that can be measured and evaluated, which are two requirements of impact investing. Social impacts vary from creating jobs to improving health, education, etc. In this regard, there are various ways to invest directly in companies/foundations/NGOs through venture capital or social impact funds, such as the green retail sukuk which was just issued by the government on November 25 2020.

The potential for impact investment in Indonesia has been studied by the Angel Investment Network Indonesia (ANGIN), which has identified four promising investment sectors: agriculture, waste management, genderless investment and SME digitalization. However, it is difficult for these four sectors to obtain funding from both the government and the private sector because of the high risk, which has the potential to cause payment failure. Therefore, with the potential for significant sustainable investment, it cannot be denied that there is a need for good business development in the future so that people have an understanding of the climate crisis and the implications of whatever they do. Transparency is the key to long-term investment success.[8]

In this case, it is essential to understand ESG investment strategies, which consist of two broad categories. The first category is a responsible investment, which aims to avoid negative impacts on the environment and society (not harm). The second category is an investment that aims to have a positive impact on the environment and society (do good) or what is usually called impact investment. Therefore, several ESGs need to be understood, namely:

a. The Exclusionary Strategy is a simple form of negative screening and is still widely used by investors today. This strategy aims to screen companies that are considered to have a negative impact on the environment and social. Usually, businesses that are considered to have a negative impact on the environment and society, such as cigarettes, coal, gambling, and the like, will be avoided by investors.
b. The Best in Class strategy is a form of positive screening that evaluates and assesses companies based on ESG, environmental, social and governance factors. In this strategy, investors will only invest in companies that rank high in terms of ESG value.
c. ESG Integration strategies have developed rapidly in recent times, with investors and investment managers needing to consider environmental, social and governance factors when analyzing a company. High ESG risks can have a negative impact on sales and increase costs, so adjustments need to be made in sales and profit forecasts. Therefore, the integration of ESG factors in company analysis is very important.
d. Sustainability Theme Investment is an investment strategy that focuses on stocks or companies related to specific ESG-related themes. This strategy targets companies in the renewable energy sector that provide financial services to low-income communities. Thus, investments are made by considering positive environmental and social impacts.
e. Green Bonds are a form of investment in the form of bonds given to companies or projects that support the green agenda. An example is a clean energy company that differentiates it from other investment strategies mentioned previously.
f. Impact Investment is a form of investment that specifically targets positive environmental or social impacts. Apart from providing funds in the form of debt, Impact Investment can also provide funds in the form of shares. However, each investment object must be specifically measured and evaluated for its social and environmental impacts, and must meet certain requirements.[12]

4 Conclusion\

Sustainable investment is an investment strategy that considers ESG (environmental, social and good governance) factors to ensure the sustainability of the economy and life on Earth. Only companies that have a positive impact and do not harm the environment and surrounding communities are investment targets. It is important to note that companies that pay attention to the environment and society are not just those with high CSR but also companies that integrate this concern into their business models and operations. Besides environmental factors, sustainable investment also considers social aspects and good governance. Investors tend to choose investments that consider social or governance factors rather than those that only consider environmental factors.

To ensure human survival and well-being, there needs to be continuous support from nature. However, lifestyle, production and consumption currently cannot guarantee this sustainability. Therefore, investment must support the transformation towards sustainable development, where profit, people and the planet are interrelated. Investments, especially in the financial sector, are essential in achieving this goal. Sustainability principles will become the new norm in the world of finance and investment shortly. Indonesia must prepare and join this movement to ensure a sustainable development strategy. Sustainable investing, including impact investing such as ESG, continues to grow worldwide. According to the latest Global Impact Investing Network (GIIN) survey in April 2019, impact investment managed funds have reached 502 billion US dollars. Likewise, according to the latest data from the Climate Bond Initiative (CBI) in March 2020, the issuance of green bonds, which are included in the impact investment category, has reached 805 billion US dollars.

Investors interested in impact investing actively seek opportunities to put their capital into businesses, nonprofit organizations, and funds focused on renewable energy, housing, healthcare, education, microfinance, and sustainable agriculture. Institutional investors such as development financial institutions, pension funds, and endowments are essential in expanding impact investing in North America and Europe. Even the Catholic Church, under the leadership of Pope Francis, is increasingly interested in investing in impact investing. Various investment instruments and vehicles are available in impact investing, and in general, this investment offers financial benefits that align with awareness of environmental impacts. Investment targets are usually the health, education, renewable energy and agriculture sectors, often directed towards developing countries for vulnerable groups such as women and SMEs. However, large companies demonstrating social responsibility and commitment to the community and environment are also eligible for this investment scheme. There are two general approaches to impact investing: the environmental, social and governance (ESG) approach and the social responsibility (CSR) approach.

Investment activities can have an impact when implemented in other countries to support businesses that provide economic benefits and have a social and environmental impact in the country where the business operates. According to a study by the Global Impact Investing Network (GIIN), impact investing has increased from USD 4.3 billion in 2011 to USD 502 billion in 2018 and is expected to reach USD 1 trillion by 2020, while traditional investing focuses only on financial profits. Impact investing emphasizes the potential for financial and social/environmental returns. In Indonesia, despite the global pandemic, investment increased by 8% compared to the previous year in 2019, with the most significant increase coming from Domestic Investment (PMDN), contributing 53% of total investment.

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