

PROFILES OF INVESTOR SYSTEMS AND RELATED APPROACHES

SARONA ASSET MANAGEMENT (SARONA)

Asset manager: Responsible/impact investment specialist * Headquarters: Canada * AUM: US\$200 million (2016)¹

AT A GLANCE

Sarona is a private equity investment firm that invests in emerging markets with the goal of achieving risk-adjusted returns and positive impact. It focuses on small- and medium-sized enterprises that manufacture and provide goods and services to the lower and emerging middle classes in developing economies. In 2011, Sarona was spun off from Mennonite Economic Development Associates (MEDA), a development financial organization with a similar focus.

Sarona is a fund-of-fund manager that seeks investments in private equity funds that create quality jobs, reduce environmental footprints, empower women, promote corporate governance and build sustainable communities.

It measures and reports on its impacts at the “immediate” level of the companies in which it invests; the “strategic” level of the private equity industry and its ability to influence private equity fund managers to incorporate impact in their investment practices; and the “fundamental” level of global collaboration to create investment tools that facilitate scalable impact and blended finance.

TOOLS OF INTENTIONALITY

- | | |
|---|---|
| <input checked="" type="checkbox"/> Additionality | <input type="checkbox"/> Polity |
| <input type="checkbox"/> Diversity of Approach | <input checked="" type="checkbox"/> Self-Organization |
| <input type="checkbox"/> Evaluations | <input type="checkbox"/> Solutions |
| <input type="checkbox"/> Interconnectedness | <input checked="" type="checkbox"/> Standards Setting |
| <input type="checkbox"/> Locality | <input checked="" type="checkbox"/> Utility |

ON-RAMPS

- | | |
|---|---|
| <input checked="" type="checkbox"/> ESG integration | <input type="checkbox"/> Long-term value creation |
| <input checked="" type="checkbox"/> Impact investment | <input type="checkbox"/> Universal ownership |
| <input type="checkbox"/> Investment stewardship | |

ASSET CLASSES INTEGRATED INTO

- | | |
|---|--|
| <input type="checkbox"/> Fixed income | <input type="checkbox"/> Public equities |
| <input type="checkbox"/> Infrastructure and real assets | <input type="checkbox"/> Real estate |
| <input checked="" type="checkbox"/> Private equity | <input type="checkbox"/> Venture capital |
| <input type="checkbox"/> Other | |

YEARS INTEGRATING

Sarona has focused on economic development in emerging markets since it was spun off from MEDA in 2011. It has published its Annual Values Reports

SYSTEMS & THEMES FOCUSED ON

- | |
|---|
| <input checked="" type="checkbox"/> Environmental |
| <input type="checkbox"/> Biodiversity |
| <input type="checkbox"/> Climate change |
| <input checked="" type="checkbox"/> Natural resources |
| <input type="checkbox"/> Oceans |
| <input type="checkbox"/> Renewable energy |
| <input type="checkbox"/> Sustainable land use |
| <input type="checkbox"/> Waste management and pollution |
| <input checked="" type="checkbox"/> Water |
| <input type="checkbox"/> Other |
| <input checked="" type="checkbox"/> Societal |
| <input checked="" type="checkbox"/> Consumer health and safety |
| <input type="checkbox"/> Corporate governance |
| <input checked="" type="checkbox"/> Corruption |
| <input checked="" type="checkbox"/> Employment, labor rights and working conditions |
| <input type="checkbox"/> Food production and security |
| <input type="checkbox"/> Human rights |
| <input checked="" type="checkbox"/> Income inequality and financial inclusion |
| <input type="checkbox"/> Infrastructure |
| <input checked="" type="checkbox"/> Social equality and diversity |
| <input type="checkbox"/> Other |
| <input checked="" type="checkbox"/> Financial |

for the past **five years**, since 2012.

- Shareholder rights
- Stability
- Transparency
- Development of private equity industry

TOOLS OF INTENTIONALITY: THE SARONA "TIIPING" POINT

Sarona has taken intentional steps to use the tools of **Additionality**, **Self-Organization**, **Standards Setting**, and **Utility** to enhance its impact investment activities and to address issues of job quality, the empowerment of women, corporate governance, sustainable communities and the environment.

- As described in the "Targeted investment programs" section of the profile, Sarona seeks to identify private equity funds that address the needs of local communities and the growing demand for goods and services in Low and Middle Income Countries. It uses the tool of **additionality** to lift the historically underserved towards a more inclusive and healthier society that also empowers women.
- As described in the "Other Activities" section of the profile, Sarona collaborates with governments to develop financial instruments that, through a **self-organized** infrastructure, facilitate and promote private equity impact investments in emerging markets.
- As described in the "Security selection and portfolio construction" section of the profile, Sarona adopts and expands upon the exclusionary investment guidelines developed by the International Finance Corporation to **set standards** for the types of businesses in which it will not invest, such as tobacco, weapons, alcohol, gambling and extractive/mining industries and companies with substantial controversies relating to corruption or child labor.
- As described in the "About" section of the profile, Sarona is an advocate for the **utility** of private equity for sustainable economic development in emerging-market countries, both through the monitoring of the private equity funds in which it invests and through collaborations with governments to encourage sustainability initiatives.

In addition, Sarona has taken steps, exceptional in the investment industry, to monitor, measure and report on the impacts of its investments not only at the "immediate" level of the holdings in the funds in which it invests, but also on a "strategic" level through which it hopes to move private equity managers to a greater awareness of their ability to incorporate social and environmental impacts into their investment processes; and on a "fundamental" level at which—in collaboration with the public sector—it creates financial tools and instruments that alter the structure of private equity vehicles in ways that increase their attractiveness for private sector investors.

Through the use of these tools, and its monitoring, measuring and reporting efforts, Sarona demonstrates its commitment to: investing in underserved communities to promote financial inclusion and social equality and diversity (Additionality); advancing the capabilities for private equity investment in emerging markets through the creation of financial tools and infrastructure (Self-organization); upholding international norms and values through its investment screening (Standards setting); and advocating for the use of private equity as an asset class to help achieve economic development and financial inclusion (Utility).

ABOUT SARONA

Since the 1950s, Sarona and its predecessor organization MEDA have been private equity investors focusing on impact investing in emerging markets and specializing in investments in small- and medium-capitalization companies. It adopts a "fund-of-funds" approach, investing in numerous private equity funds that are in turn specialists in locally oriented, emerging market investing. In

2017 it made investments through 32 such funds, which in turn invested in 272 companies in 54 emerging market countries. Numerous of these funds focus on microfinance and financial inclusion, while others focus on sectors such as healthcare and education. Sarona invests in various other sectors always considering “ethical and ESG [(environmental, social and governance)] factors when making investment decisions, evaluating opportunities from both an ESG risk mitigation and value creation perspective” (Sarona (2016)).

Sarona views emerging markets, with their increasing levels of development and growing middle classes, as providing opportunities for sound financial investments with social and environmental benefits. Its investment philosophy is built on three principles:

- Making private investments in emerging markets;
- Striving for strong financial returns; and
- Incorporating ethical, social and environmental values.

Sarona’s six key impact objectives are:

- Creating jobs;
- Improving job quality;
- Empowering women;
- Reducing environmental footprint;
- Improving governance; and
- Building sustainable communities (e.g. financial inclusion through microfinance and supporting small-business vendors) (Sarona 2017: 21).

Its five major environmental objectives are:

- Pollution prevention and waste management;
- Energy and fuel efficiency;
- Sustainable energy;
- Water resources management; and
- Sustainable land use.

In 2017, Sarona endorsed the Stockholm Declaration, committing to support the U.N. Sustainable Investment Goals (SDGs) and began mapping the alignment of its investments across the 17 SDGs.

Sarona is a fund-of-funds manager of private equity firms specializing in economic development in emerging markets, and as such advocates for the use of private equity in bringing sustainable economic development to these countries. It engages with fund managers to encourage their understanding of the role they can play in such development both in its manager selection and monitoring process and by surveying and scoring the sustainability impact of the companies that these funds invest in, as well as through collaboration with governments to encourage and facilitate greater incorporation of climate change, healthcare, and women’s empowerment considerations into emerging-market private-equity funds’ practices.

In 2011, Sarona was spun off from MEDA (Mennonite Economic Development Fund), a development financial organization founded in 1954. MEDA’s first investment was in a Paraguayan dairy farm named Sarona. MEDA continues to hold a minority position in Sarona Asset Management and outsources the Sarona Risk Capital Fund to Sarona’s advisory services. MEDA is also an investor in

the Sarona Frontier Markets Funds I and II. As a development financial organization, MEDA makes a combination of grants, equity and loans investments, primarily to the rural poor and farmers. In its *2017 Annual Values Reports*, Sarona provides case studies of two grants disbursed by MEDA to companies in the Sarona Frontiers Markets Fund 2.

Sarona is a certified B Corporation.

APPROACHES IN PRACTICE

➤ INVESTMENT ACTIVITIES

Investment beliefs statements

Sarona has a formal beliefs statement that spells out the rationale for its commitment to the integration of ESG factors into its investment process: “applying ethical, social and environmental criteria to each investment decision builds a better world for current and future generations. We further believe that such values help achieve strong financial returns” (Sarona (2017: 5)).

Security selection & portfolio construction

Sarona integrates ESG throughout its investment process.

Sarona excludes the following industries from investment:

- Weapons, alcoholic beverages, tobacco and gambling (**consumer health and safety**);
- Radioactive materials (except for medical and quality control purposes);
- Unbonded asbestos fibers and drift net fishing; and
- Extractive **mining industries (natural resources)**.

Sarona adopted and expanded this list from the exclusion list developed by the International Finance Corporation.

The funds through which it invests must also avoid investments involving **forced labor or child labor (employment, labour and working conditions)**, **corruption**, and any other form of unethical behavior.

Corporate engagements

In order to enhance impact investment within the private equity industry, Sarona engages directly with the general managers of the 32 funds through which it invests on their impact investing policies and practices. Through its annual survey and direct work with these managers in areas where Sarona sees room for improvement, it encourages these fund managers to play a leadership role in moving the emerging-markets private equity industry toward a deeper understanding and greater emphasis on positive environmental and societal impact.

Targeted investment programs

As a fund-of-fund investor, Sarona seeks to identify emerging-market private equity funds that specialize in impact investing and are aligned with its key impact objective: namely to support entrepreneurial companies that address the **needs of local communities (income inequality and financial inclusion)** and the growing demand for goods and services in low and middle income countries, and to lift the historically underserved towards a more inclusive and healthier society that also **empowers women (social equality and diversity)**.

Sarona's *Annual Values Report* includes case studies of two of the funds through which it invests. Its 2017 report profiled:

- Apis Partners, which manages funds that invest in financial services promoting inclusion, such as microcredit, transfer payments, affordable health insurance, and electronic payments services; and
- Women's World Capital Partners, which manages funds that invest in microfinance services that support women in emerging markets.

Manager selection, directives & monitoring

Sarona uses a Social and Environmental Management assessment tool that scores fund managers on:

- Leadership: commitment to leadership in the field;
- Management: strength of policies, capacity and culture around ESG management;
- Investment Process: integration of ESG into due diligence, ownership and exit strategies; and
- Reporting: thoroughness in ESG reporting.

When it identifies areas of weakness in current funds, it develops plans for improvement. It will not invest in the managers of funds unwilling to make such improvements.

➤ OTHER ACTIVITIES

Collaborates on organizational infrastructure building

Sarona has collaborated with various governmental agencies to develop financial tools that serve as self-organizing infrastructure facilitating and promoting the development of private equity as an asset class that can promote impact investment in emerging markets. Among these projects are:

- Developing its first blended finance investment structure in 2014, Sarona Frontier Markets Fund 2, which raised \$150 million in collaboration with the Canadian and American governments, and private sector investors from North America and Europe, and that provides the possibility to provide MEDA grants to portfolio companies;
- Working to address the challenge of currency risk in emerging markets investing, sponsored by U.S. Agency for International Development and in cooperation with the Emerging Markets Private Equity Association and Chrytalus;
- Investigating with the Canadian government on the design of an emerging-markets fund to address **climate change** and empower **women (social inclusion and diversity)**;
- Exploring the feasibility of an Africa Healthcare fund with support from the Centre for Global Health and Diplomacy; and
- Partnering with Global Affairs Canada and MEDA to create short-term funding mechanisms for small- and medium sized businesses in emerging markets.

➤ STAFFING

Sarona's staff includes a Head of Investor Relations, ESG & Impact.

➤ IMPACT MONITORING & REPORTING

Sarona monitors and measures its impact on three levels:

- **Immediately.** Sarona tracks the social and environmental impacts of the companies in which it is invested as a measure of "improving lives on the ground."

- **Strategically.** It uses its influence on private equity funds within the emerging markets investment community to promote impact standards and procedures that “[build] institutional capacity.”
- **Fundamentally.** It uses its position as an innovator and collaborator to promote investments by private equity firms that “change systems and societies for the better over time” (Sarona (2017): 4, 9).

To measure its immediate “on-the-ground” impact, in 2017 Sarona surveyed 220 companies held by the 32 funds in which it invested using 22 IRIS metrics. Based on the responses it received from these companies (145), Sarona reported on its investments along the following societal and environmental parameters:

- Jobs created (e.g. 15,000 created in 2017);
- Improvements in job quality (e.g. 33% increase in job training);
- Empowerment of women (e.g. 18% of managers on average are now women);
- Environmental footprint (e.g. 2,000 megawatts of total clean energy generating capacity);
- Governance improvements (e.g. \$234 million in corporate taxes paid, up 15% from 2015); and
- Building of sustainable communities (e.g. a total of 85 million clients benefited from portfolio companies activities, up from 73 million in 2015).

At the second, strategic, level Sarona notes that its impact “is not easily measurable, yet possibly more significant and longer lasting than our direct impact through portfolio companies” (Sarona (2017): 13). Through a variety of inputs at this level, Sarona seeks to raise the level of awareness, among the managers of those funds in which it invests and the hundreds of funds that it considers for investment, about the value of environmental and societal impacts. Sarona reports that it has:

- Worked with a number of the funds in which it has invested, including Kandeo Investment Advisors, Mediterrania Capital Partners, Proventeus Capital Partners, and Creador, to develop ESG and impact investment guidelines. As a result, for example, Kandeo now has an impact investment advisor and publishes an impact report.
- Developed impact case studies to be used by its current and prospective managers to assist them in understanding and communicating the environmental and societal impacts of their investments.
- Partnered with Global Affairs Canada and MEDA to provide grants that encourage investee companies to implement innovative social and environmental programs and contribute to the general awareness of the benefits of such initiatives. It has made 30 of these Sustainable Innovation Grants to firms in 17 countries.

For the funds in which it invests, Sarona applies its Social and Environmental Management assessment tool which scores fund managers on leadership, management, ESG integration and reporting.

At the third, fundamental, level, which Sarona views as its contribution with the farthest reaching impact, Sarona notes that there are “no benchmarks, no metrics and no definitive way of quantifying this impact” (Sarona (17: 9)), but points to a number of specific initiatives that address system-level concerns (including those discussed in the Other Activities section of this profile).

In 2017, Sarona began measuring the alignment of its investee companies with the Sustainable Development Goals. It reported that for Goal 8 Decent Work and Economic Growth and for Goal 16 Peace, Justice and Strong Institutions, 100% of its investee companies made contributions and as did nearly 50% of firms for Goal Five Gender Equality. While these figures demonstrate the alignment of Sarona’s portfolio companies with the SDGs, it also notes that in the end “it is up to the U.N. and each country to report their progress on the SDGs” (Sarona (2017: 19)). In its *2017 Annual Values Reports*, Sarona provided case studies of six investee companies that included a description of their alignment with the SDGs.

POLICY DEVELOPMENT AND MONITORING

N/A

SUCCESSSES AND CHALLENGES

N/A

SOURCES

Hoffmire, John . *Sarona: A private investment firm with a heart*. Deseret News. Salt Lake City, Utah: August 9, 2016. Accessed from <http://www.deseretnews.com/article/865659714/Sarona-A-private-investment-firm-with-a-heart.html> on August 24, 2017.

Sarona (2016). *Environmental, Social, Governance and Impact Policy*. Sarona Asset Management. Kitchener, ON: 2016. Retrieved from <http://www.saronafund.com/user-files/uploads/2016/09/Sarona-ESGI-Policy-Aug-2016-4.pdf> on August 24, 2017.

Sarona (2017). *Annual Values Report 2017: Growth that Matters*. Sarona Asset Management. Kitchener, ON: 2017. Retrieved from <https://www.saronafund.com/responsible-investment/values-reports/> on August 24, 2017.

NOTES

¹ Correspondence with Sarona, August 30, 2017.

Profile developed in: August 2017.

Profile developed by: The Investment Integration Project (TIIP). TIIP helps institutional investors understand the big picture, or “systems-level,” context of their portfolio-level decisions. “Systems-level” events, such as economic crises, ecosystems under stress, and societies in turmoil can disrupt the best-laid plans of investors and cost them dearly. Even seemingly “local” issues are now having much greater impact than they once did as the world becomes increasingly interconnected.

TERM DEFINITIONS

What are "Tools of Intentionality"?

Tools of intentionality are specific pathways through which investors can bridge the gap between daily portfolio management decision-making and systems-level investing. Investors use these tools intentionally because the portfolio-level discipline of efficiency alone does not naturally lead them to systems-level considerations. Investors can use these tools to manage risks and rewards at systems levels and facilitate impact in a variety of ways.

What are "On-Ramps"?

On-ramps are investment approaches that represent logical extensions of the concept that investment has impact on the world at large—and on its component environmental, societal and financial systems—and that that impact can be managed to maximize these systems' wealth-creating potential in society.

What are "Asset Classes Integrated Into"?

Into which asset classes does the investor incorporate a systems-related approach?

What are "Years Integrating"?

The number of years since investor initiated systems-related approaches.

What is the "Tipping Point"?

Description of investor's primary approaches to adopting/executing system-related considerations.

What is "About"?

General description of the investor and their approach to systems-related investing.

What are "Approaches in Practice"?

How does the investor's systems-related approach manifest itself? We examine five key investment activities as well as other intentional systems-related undertakings. We also look at staffing and impact monitoring and reporting.

What are "Investment Beliefs Statements"?

Inclusion of observations about environmental, societal or governance considerations in the investor's formal investment belief statements or in more general statements of beliefs about the relevance of these considerations at portfolio or systems levels.

What are "Security Selection & Portfolio Construction"?

The incorporation of environmental, social and governance factors into individual security valuation and portfolio construction.

What are "Targeted Investment Programs"?

Creation of specialized sector or theme-based funds with an explicit environmental or social focus and the stated purpose of serving sustainable or responsible investors.

What are "Corporate Engagements"?

Communication on environmental, social and governance issues with corporations indirectly through proxy voting, or directly through individual or collaborative dialogue, the filing of shareholder resolutions, or other means in order to promote improvements in practice.

What are "Manager Selection, Directives and Monitoring"?

Incorporation of systems-related or on-ramp themes into the selection and monitoring of external managers.

What are "Other Activities"?

Additional investment policies and practices beyond those captured in key investment activities. Those intentional policies and practices that seek to achieve systems-goals are highlighted. They vary considerably across investors.

What is "Staffing"?

When information is available, this section describes investor contracting with external entities to execute systems-related approaches; internal personnel whose responsibilities exclusively or primarily include developing, executing or overseeing investor systems-related approaches; committees/groups with systems-related responsibilities; training provided to staff.

What is "Policy Development and Monitoring"?

When information is available, describes the processes undertaken by the investor to develop systems-related approaches.

What is "Impact Monitoring and Reporting"?

Discusses whether and how the investor measures and reports on the non-financial outputs, outcomes or impacts (effectiveness) of its systems-related approaches, or has plans to do so. Also whether and how the investor reports on the content of its systems-related activities.

What are "Successes and Challenges"?

Discusses the main successes and challenges reported by the investor about its systems-related approaches. This includes successes and challenges reported on a TIIP survey or in an interview, or statements describing successes and challenges in publicly available materials.