Sturgeon Insights

An introduction to Sturgeon's impact investing approach

Sturgeon believes that investments in Central Asia can generate exaggerated social impact per dollar invested due to the current low development base and the lack of available capital. Incorporating impact measurement and management throughout our investment process increases the resiliency of our investee companies, and in doing so ensures the sustainability of the impact generated and the strength of returns to our investors. Impact is a core part of our investment analysis, from the sourcing of deals to exit, and it plays a key role in risk management.

What do we mean by impact investing?

"Above all, ***job creation*** will be the key factor for developing countries to ***reduce poverty***, ***improve people's lives***, and ***reach the Sustainable Development Goals by 2030***… Creating more and better jobs requires economic transformation:…it is ***essential to harness the technological innovation and entrepreneurship*** that the digital age has unleashed"

Axel van Trotsenburg, Vice-President of Development Finance, World Bank (2018)

The central premise of our impact framework is that investing in innovative, technology-enabled companies that create private-sector jobs can generate long-term sustainable social impact and superior financial returns for investors. This framework delivers meaningful social impact by empowering private entrepreneurs to grow their businesses, in turn creating employment opportunities which we believe are the most effective driver of social change in developing markets.

Across our portfolio, Sturgeon encourages technology adoption and innovation, bringing in international expertise to train local employees and insisting upon the highest corporate governance standards. The efficient and profitable companies our approach fosters are also more resilient during periods of economic volatility.

Establishing Sturgeon's Fund targets

1. Our Fund targets: Sturgeon Uzbekistan Growth Fund (SUGEF) has dual-targets:

i. Ensure every portfolio company realises a 40% internal rate of return (IRR)[1]

ii. Support 500,000 jobs through our investee companies[2] by encouraging technological innovation for SMEs and the mass market.

Empowering people through employment can deliver long-term, sustainable and productive social impact. This is even more the case for the region's youth, on whom the future success of their economies depends. Please see the appendix for a breakdown of regional unemployment data.

2. The mechanism for impact: We enable change by providing companies with capital and technical expertise to empower entrepreneurs to grow their business and in doing so increase individual and societal wealth. There is a real necessity for product and service innovation to meet the needs of 87 million consumers in the region.

3. Key Performance Indicators (KPIs): We have developed a system of quantitative and qualitative KPIs to track the performance of our portfolio against both impact and financial return objectives: these metrics are complementary and inseparable. KPIs are grouped into three categories: impact; risk management, which includes environmental, social and governance (ESG) risks; and financial. Our KPIs across all three categories drive businesses around outputs and outcomes that are critical to achieving our financial and social return objectives. In this article, we summarise our approach to tracking impact KPIs which are directly measurable and aligned with the company's financial bottom line.

[1] Please contact Sturgeon for a detailed breakdown of how we calculate our financial return objective.

[2] 'Support' is defined as both staff employed directly by investee companies, as well as jobs in directly supported/ financed enterprises. See appendix.

Applying Sturgeon's impact framework

Sourcing and screening

As part of our initial due diligence process, every investment is screened through the lens of our UN Sustainable Development Goals (SDGs) traffic light system. When a company passes our initial due diligence and impact screens, we undertake a more comprehensive due diligence assessment.

Sturgeon uses the SDGs as the basis for our impact objectives, specifically Goal 8.2 to "achieve higher levels of economic productivity through diversification, technological upgrading and innovation" and Goal 8.5 to "achieve full and productive employment and decent work for all,". We believe our companies are well-positioned to support SDGs 1, 8 and 9 which according to research by SDSN and Bertelsmann Stiftung[3] are among the most difficult for developing countries to achieve. Many of our companies also actively contribute to other SDGs.

1 NO POVERTY	To end poverty in all its forms everywhere.	8 DECENT WORK AND ECONOMIC GROWTH	To promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all.	9 INDUSTRY, INNOVATION AND INFRASTRUCTURE	To build resilient infrastructure, promote inclusive and sustainable industrialisation and foster innovation.

We summarise Sturgeon's SDG traffic light screening approach below:

RED = FAIL (Actively negates SDG)	A company's business runs directly counter to an SDG, and there is neither the will nor the potential for this to be corrected. Any red flags during the screening mean Sturgeon will no longer consider the company an investment opportunity.
ORANGE (Indirectly negates)	A company's current business activities do not run directly counter to an SDG, however their operations may hinder, or slow, progress towards achieving an SDG. In this scenario, Sturgeon will consider the likelihood and severity of a negative impact, bearing in mind the company's results against other SDGs. Where a company has orange flags against one or more SDGs, Sturgeon will engage with management to adapt their business model to reduce or eliminate the negative impact. If there is no willingness from management and the company to engage with the process, this can lead to Sturgeon no longer considering the company for investment.
BLUE (Passive/indirect contribution)	A company's business passively or indirectly contributes towards an SDG. In this scenario Sturgeon will analyse the potential impact of the company for an SDG, and the potential for its contribution to be increased or become active.
GREEN (Active contribution)	A company actively contributes to furthering progress towards an SDG. Sturgeon prioritises businesses which actively contribute to our core SDGs, and we use a company's green flags to establish and adapt impact KPIs. Through highlighting a company's green flags, we can focus our due diligence on the key parts of the products/services and the business strategy which will consolidate and increase the company's social impact.

3 For more details please refer to the Sustainable Development Report 2019 (includes SDG Index and Dashboards). Published by Bertelsmann Stiftung and Sustainable Development Solutions Network.

Applying Sturgeon's impact framework (continued)

Investment management

To reduce information asymmetry and monitor potential investment targets, we go beyond the financial reports and management projections. Following our initial rounds of questioning, we establish all the key variables that drive a given business and map them on to trackable data points. We then work with individual companies to develop an infrastructure which allows us to monitor verifiable data points in real-time. This system provides us with reliable data to monitor the business and guide our discussions with management. This data infrastructure is kept in place throughout our investment holding period and is a key component for informing our strategy.

Sturgeon uses the GIIN's IRIS+[4] system to measure, manage and optimise impact across its investments. As one of the most widely used systems for impact measurement and management, we rely on IRIS+ as the basis for developing our portfolio and investment specific KPIs. Choosing KPIs is a detailed process for each investment, and where necessary we adapt IRIS+ metrics to be relevant or develop our own.

The IRIS+ metrics, once adapted for each investment, form the basis of the reporting framework we implement with our investee companies. This framework tracks the KPIs on a quarterly basis, allowing us to monitor each companies' performance and act when necessary to mitigate or encourage products, services and strategic decisions that relate to our impact objectives. Tracking these impact KPIs is intertwined with our financial and risk management KPIs – in many cases they are interchangeable – and we believe that incorporating all three aspects in our portfolio management leads to more resilient companies, sustainable social impact and high returns for investors.

We have provided a few examples of Sturgeon's impact KPIs in support of employment, training and innovation below. Company KPIs are then aggregated to gauge our progress towards our targets at a portfolio level.

Sample Impact Metrics		
Impact	**Metric**	**IRIS+ Code**
Employment	Permanent Employees: Total	OI8869
	Permanent Employees: Female	OI2444
	Permanent Employees: Youth Under 30	n/a
	Jobs in Directly Supported/Financed Enterprises	PI4874
Training	Employees Trained	OI4229
	Employee Training Costs	OI7390
	Organisations Trained	PI6065
Innovation	Business Innovation	OI4718
	Spending on R&D	n/a
	Employees Focused on R&D	n/a

[4] For more details please refer to the IRIS+ website (https://iris.thegiin.org/metrics/).

Applying Sturgeon's impact framework (continued)

Exit

The success of Sturgeon's investment framework is arguably most clearly shown upon exiting an investment. The insights, captured by our rigorous collection of data since inception, are also used to evaluate impact, financials, risk and ESG performance at exit against initial targets in order to measure the value generated by Sturgeon's investment approach.

We believe that by incorporating impact into our investment framework we can foster more resilient businesses that deliver sustainable social impact and generate superior exit valuations that drive strong returns for our investors.

For a full breakdown of Sturgeon's impact investment framework please contact the team:

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Appendix

Sturgeon considers there to be two key factors which can drive social and economic development in Central Asia and the Caucasus:

- The creation of productive, private sector jobs, particularly for youth who make up 44% of the population and for whom employment opportunities are most limited.
- The necessity for product and service innovation to meet the needs of 87 million consumers in the region.

Youth unemployment is on average more than two times higher than the general level of unemployment in these countries. This poses a significant challenge for the governments in the region, but at the same time it is also an opportunity for targeted investments to create productive jobs and generate significant social and economic impact.

The region's economies are still dominated by commodities or low value add industries, with little innovation. Uzbekistan and Turkmenistan do not even feature on the 2019 Global Innovation Index Ranking of 129 countries. As a result, there are many inefficiencies across all sectors, which can be solved by technology-enabled companies to significantly improve the quality of life and opportunity for the region's population.

Empowering people through employment can deliver long-term, sustainable and productive social impact. This is even more the case for the region's youth on whom the future success of their economies depends. We have therefore set our impact objective at a portfolio level focused on creating employment opportunities through our fund investments, with an absolute goal of supporting 500,000 jobs in our first fund. Within this we target a 30% youth employment rate, with an emphasis on training and development.

Country	Population (million people)	Youth population (% u25)	Total unemployment (%)	Youth unemployment (%)	Global Innovation Index Ranking (2019)
Armenia	3.021	30.27%	17.7%	35.5%	64
Azerbaijan	10.206	36.01%	4.9%	14.6%	84
Georgia	3.997	29.32%	12.7%	30.5%	48
Kazakhstan	19.091	39.10%	4.8%	4.8%	79
Kyrgyzstan	5.965	46.09%	4.5%	14.4%	90
Tajikistan	8.873	49.56%	6.9%	20.8%	100
Turkmenistan	5.529	41.92%	4.0%	8.3%	n/a
Uzbekistan	30.565	39.82%	13.2%	20.1%	n/a
Total/average	87.247	44.42%	8.59%	17.56%	

Sources: CIA Factbook; World Bank/ILO; WIPO

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