

Investing for Social Impact under The Eternal Blue Sky

**August 2012
Global Young Leaders Programme**

Honest Inquiry · Asia's Worldview · Ideas to Action



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Executive Summary (1/2)

Background

Mongolia is blessed with a large, fertile and resource-rich land mass, a young and highly literate population, and a crescendo of interest from foreign capital and technology partners – especially in mining.

Yet, Mongolia is also a country of pressing issues and challenges around social welfare, wealth distribution, resource allocation and the environment.

Indeed, Mongolia is at a cross-roads and is faced with distinct options and choices – the potential consequences are significant.

Mongolia is staring at the face of the Resource Curse and Dutch Disease with all of the knowledge, tools and wherewithal to chart a distinctly positive course to the benefit of all its citizens – so long as deliberate choices are made and appropriate actions are taken.

Project Scope

With targeted funding and investment into its human capital, Mongolia's Small & Medium Enterprise (SME) sector stands ready to grow dramatically, both along the Mining Services Value Chain and in key sectors identified in this report. This opportunity presents the potential for an elegant, impactful and broad-reaching solutions to some of the inevitable social challenges.

To this end, impact investing focusing on social issues/opportunities may be a critical catalyst for Mongolia, as it can enable the country to drive development along a more prudent, prosperous, independent and sustainable path.



Executive Summary (2/2)

The Proposal

This proposal highlights promising areas of social impact potential in Mongolia, including Agriculture, Education, Healthcare, Affordable Housing and Waste Management. While we are not excluding the mining supply chain, these areas are of primary importance and present significant opportunity.

The timing is right for a Social Impact Fund in Mongolia. To be effective, the fund's sponsor must be credible, its size must be prudent, its mission must be clear, and its structure must be innovative. It must be tailored for Mongolia. The criteria for investment selection and monitoring must be simple, clear, broad-based, specific, measurable and actionable. The Fund must focus keenly on alignment of interests, governance and transparency.

This proposal provides a summary of the team's recommendations. It represents a capstone of 35 top individual's efforts over the course of two short but highly-intensive weeks. While certainly not all inclusive nor all encompassing, the analysis indicates quite conclusively that the opportunity is promising and robust.

The authors thank our sponsors, hosts, leaders, teammates, and new friends for enabling such a tremendous journey of growth, exploration, discovery and accomplishment. Our sincere hope is that this preliminary work will be the beginning of many great things to come, both in Mongolia and beyond.





INTRODUCTION & BACKGROUND: THE MONGOLIA CONTEXT

Global Young Leaders Programme



The **Global Institute For Tomorrow (GIFT)** is an independent pan-Asian think tank that provides content-rich and intellectually challenging executive education from an Asian worldview. GIFT's methodology invites participants to build greater self-awareness and test personal resilience whilst creating robust new business models linked to contemporary challenges and opportunities.

The **Global Young Leaders Programme (YLP)** is GIFT's flagship experiential programme designed for managers from leading global organisations to think critically about the drivers of change in the 21st century and develop new business models that address the defining challenges of our times.

Why We Are Here?

To develop Mongolia's first Social Impact Investment Fund to improve the lives of the people in Mongolia

- New approach for growth and long-term maximisation to develop a vibrant, balanced economy and society
- Impact investing seeks to maximise social, environmental, as well as financial returns

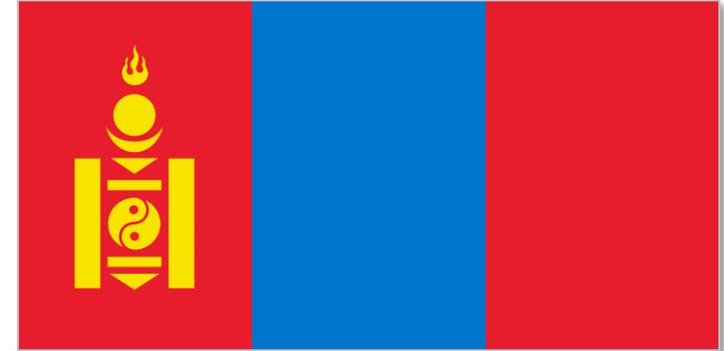
Project Partner

Mongolia today is the fastest growing economy in the world, but it is at the same time unable to provide for the basic needs of all its citizens. **TenGer Capital** believes that the creation of this fund with a focus on enabling entrepreneurs and SMEs to develop socially oriented businesses will be critical in the development of Mongolia. The fund seeks to encourage investors to invest in viable enterprises, which will have both financial and significant social impact in Mongolia.

Objectives

To produce recommendations that take into account:

- Setting up a Social Impact Fund of US\$50 – 70 million
- Investments in Small to Medium Sized Enterprises (SMEs)
- SMEs with social and environmental impact



- Founded in 1999, TenGer is a regional family of companies, which includes XacBank, XacLeasing, XacSecurity, TenGer Capital, TenGer Solutions and TenGer Insurance built to provide fair access to broad financial services.
- XacBank is the fourth largest bank by asset size in Mongolia and its nationwide branch network is the 3rd largest reaching all 21 provincial capitals.
- XacBank is a market leading bank in the provision of financial services to micro businesses and SMEs throughout Mongolia.

Socially oriented businesses led by local entrepreneurs and SMEs will help to boost the development of Mongolia

Country Overview



Country Information

Capital city: Ulaanbaatar (UB)
Total area: 1,564,116 km²
Population: 2.7 million
Official language: Mongolian
Life expectancy: 66.8 yrs
Literacy: 97.5%

Economic¹ (1Q – 2012)

Real GDP: 16.7% YoY
Inflation: 17.3% YoY
Policy rate: 13.25%
Exports: US\$ 4.9 bn
Imports: US\$ 7.0 bn
FX reserve: US\$ 2.3 bn
MNT/USD: 1,318.80

Environmental² (2011)

Forested area: 9.1%
CO2 emissions (kt): 10,894.66
Agricultural land: 74.7%
Water consumption: 540 mm³
Desertification: 72.3% (NCCDM)

Social³ (1Q – 2012)

Unemployment: 9.0%
Poverty level: 29.8%
Avg. income: ~ US\$ 500/month
Population living informal
Ger Districts: ~ 50% of total

Background: The Mongolia Context

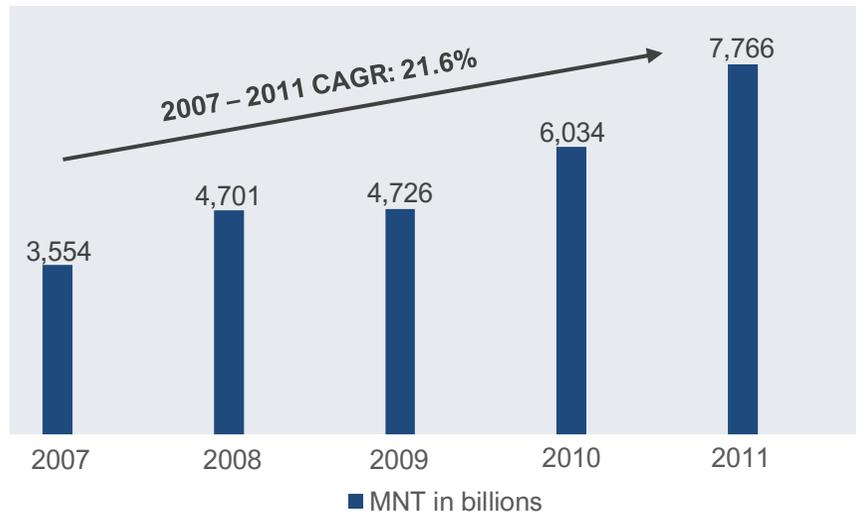
Transition

- Since 1990, Mongolia has transitioned to a free market economy and democratic system
- Private sector accounts for 70% of GDP
- Generally, stable and peaceful political environment
- Government signed Oyu Tolgoi investment agreement 2009
- Regulations addressing ownership of land and rights

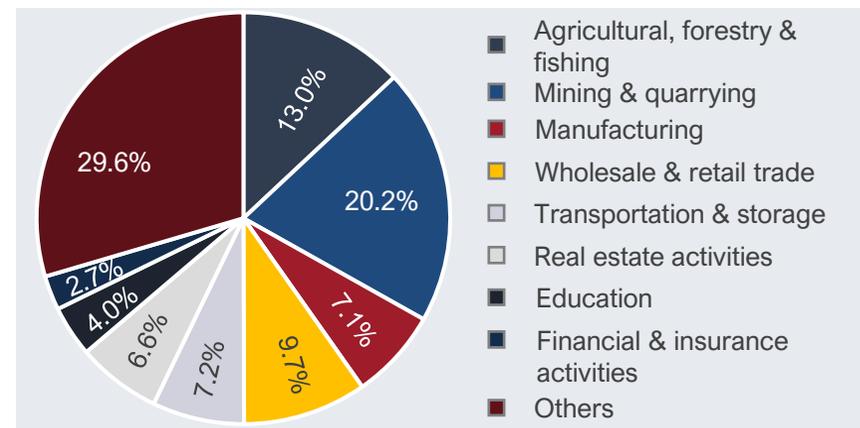
Challenges

- Landlocked with limited domestic market
- Economy is poorly diversified
- Heavily reliant on export of raw commodities (copper, gold, crude oil, cashmere, etc.)
- Harsh climate, vast territory, limited infrastructure and distant from international markets
- High inflation

Real GDP Trend of Mongolia



Nominal GDP Composition by Sector



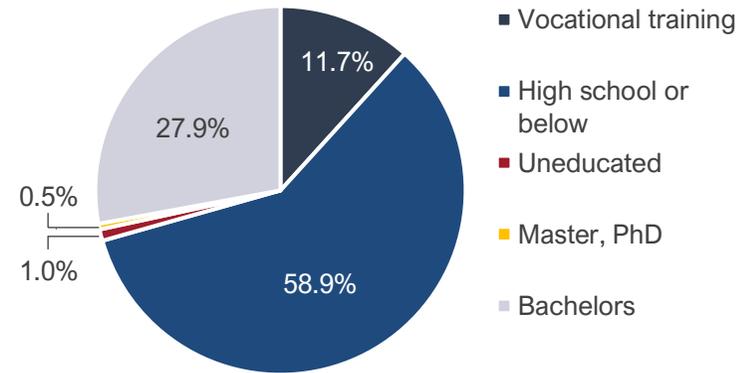
Source: NSO

Background: The Mongolia Context

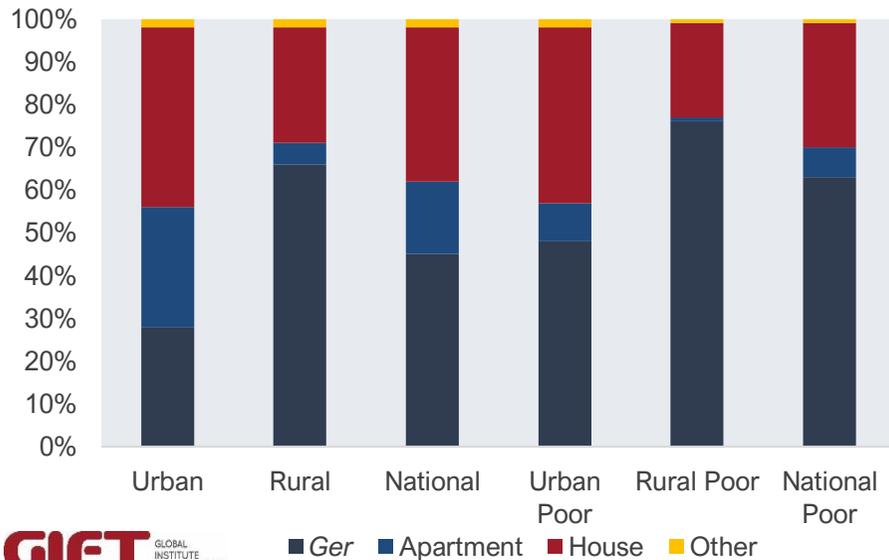
Social Issues



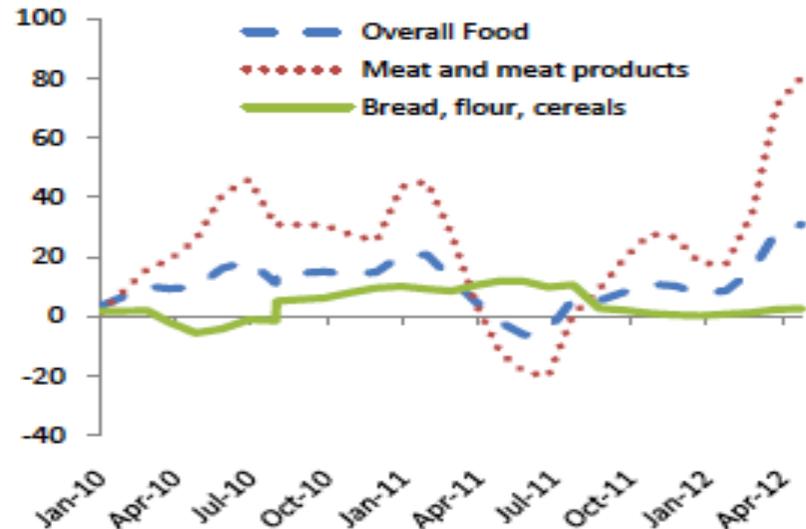
Unemployment by Education Level



Housing Standards in Mongolia



Rising Food Prices (YoY)



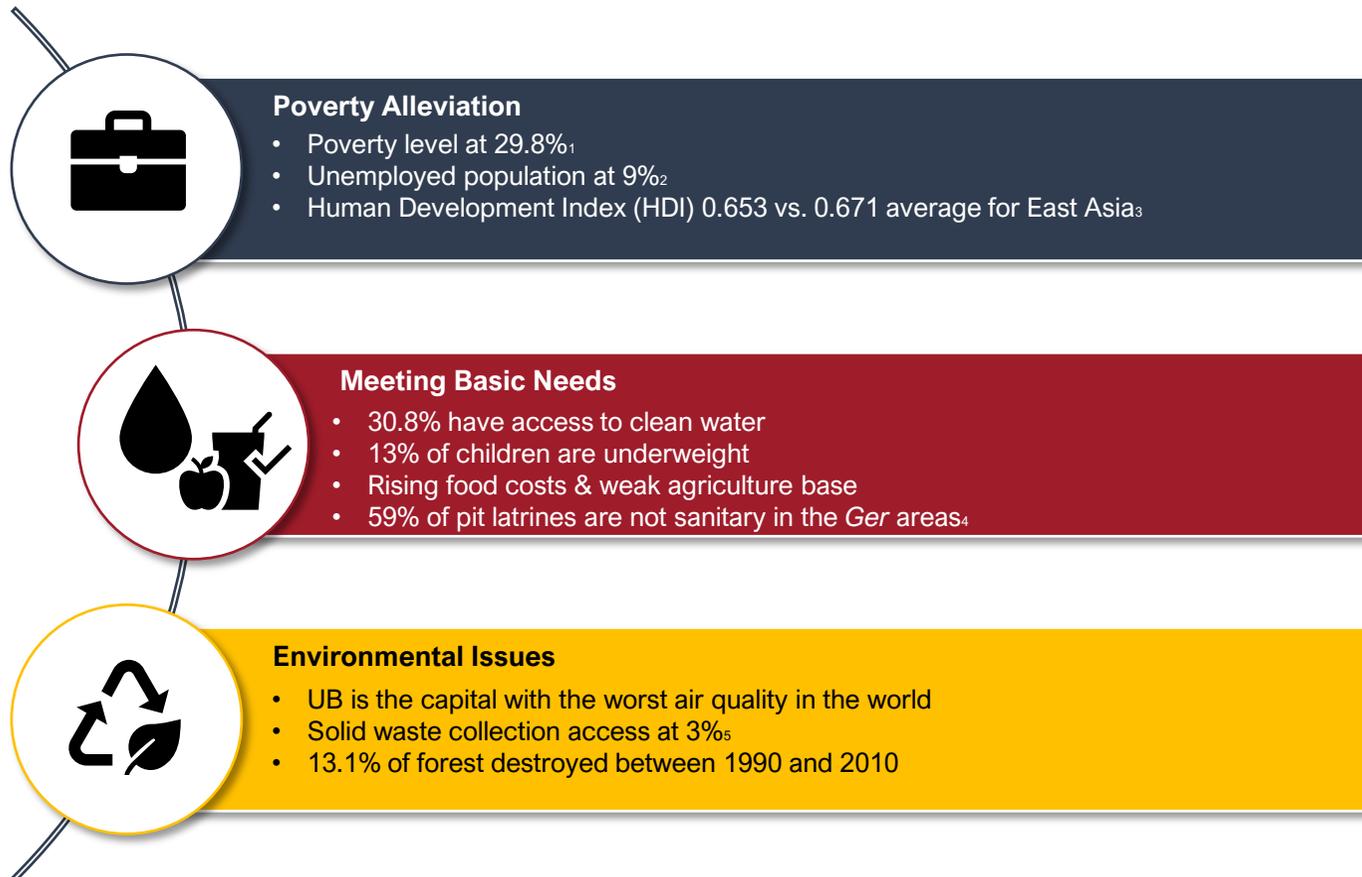


IMPACT INVESTING



Social Impact Needs of Mongolia

There are **three key areas** of focus:



¹ 2011 World Bank Household Social Economic Survey (HSES) conducted by NSO

² NSO Labour Survey or Q4 2011

³ Mongolia Human Development Report, UNDP, 2011

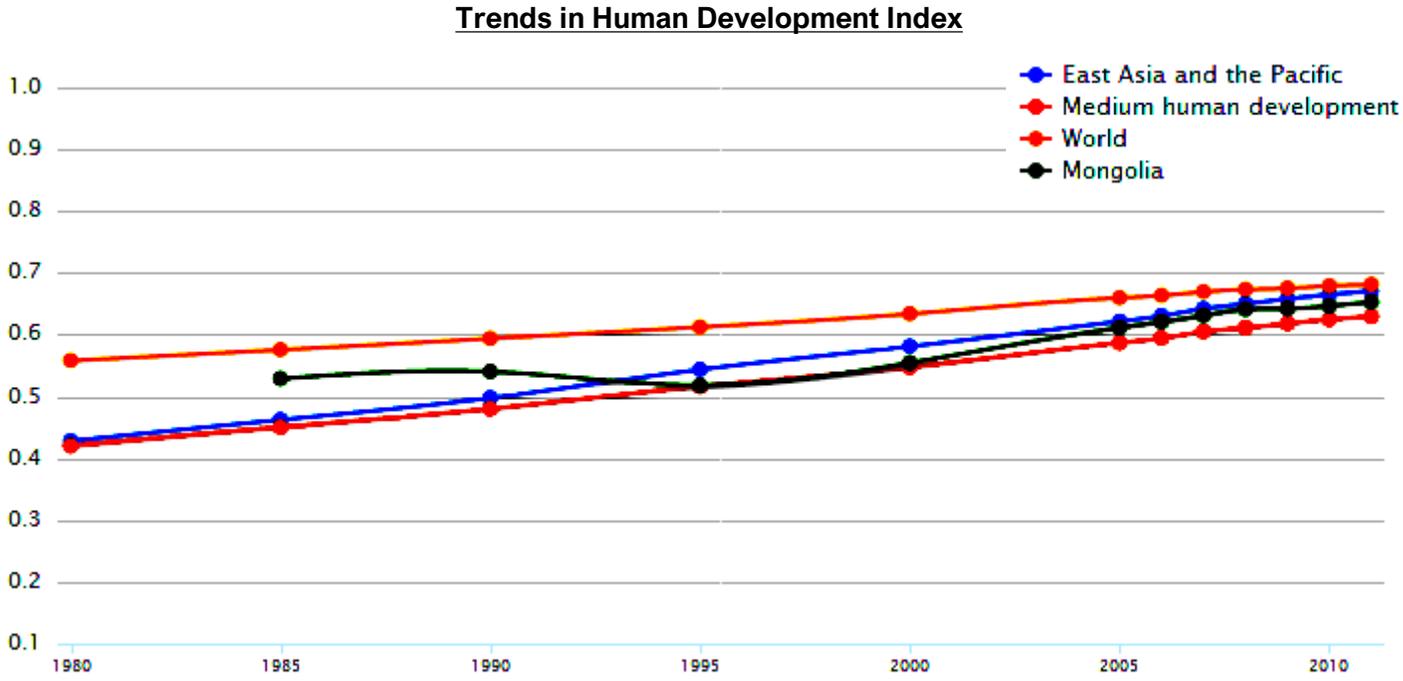
⁴ Hygiene and Sanitation Situation Report, World Bank, 2006

⁵ Mongolia Environment Health Country Profile, World Health Organisation, 2005

Poverty: Measurement Index

HDI as a standard:

The Human Development Index (HDI) is a standard used since 1990's to compare the level of human development across countries, incorporating metrics for **Income, Education and Life Expectancy**. It presents a more accurate picture of poverty than a simple measurement of the number of people 'below the poverty line'.

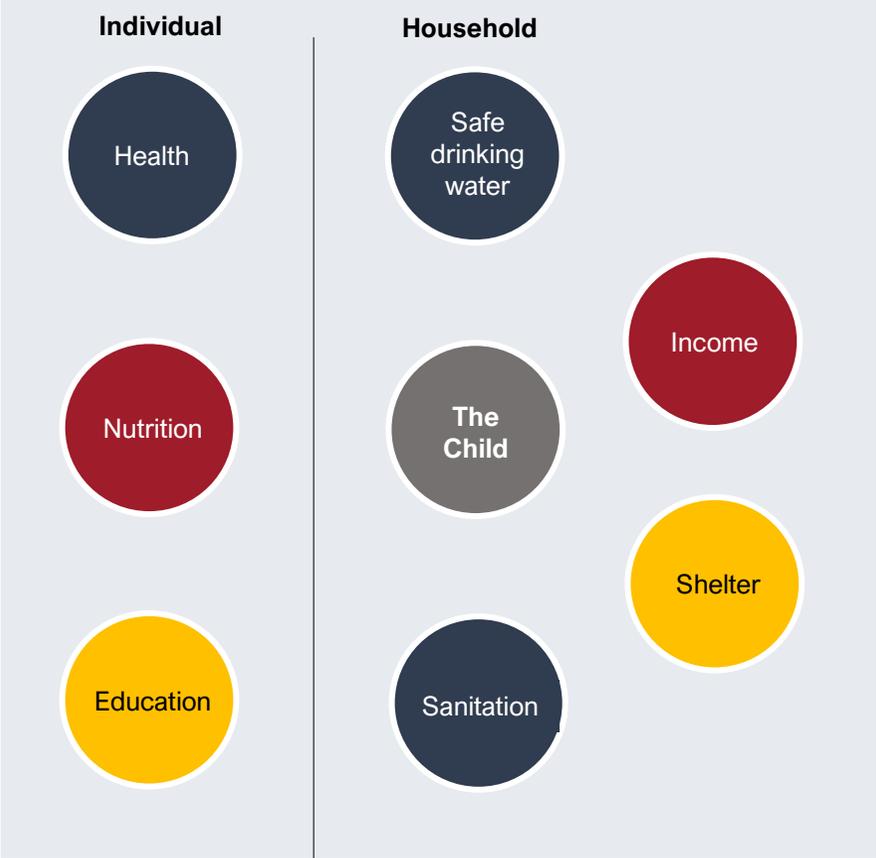


Source: UNDP

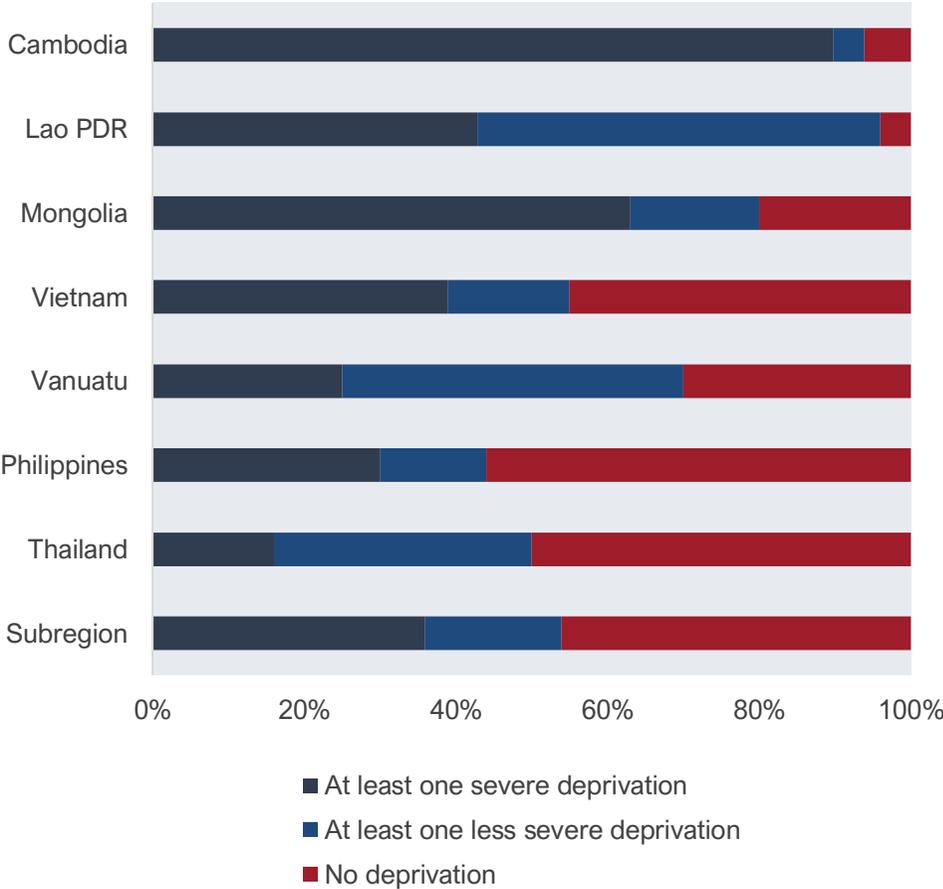
Mongolia currently ranks 110 out of 141 countries assessed

Poverty: Impact on Children

Poverty impacts children in many aspects



80% of Mongolian children are experiencing deprivation of some kind



Source: Towards Child-Sensitive Social Protection in Asia-Pacific, UNICEF, 2012

Meeting Basic Needs: Access

Poor transport links – Difficult to travel far to receive medical assistance¹

- **Over 83%** of cancer patients are diagnosed at very late stages¹
- People who live in the countryside or remote areas do not get proper diagnosis and treatment

People dig their own pit latrines and lack adequate knowledge on how to construct these latrines²

- **10,000 cases** of diarrhoea recorded every year²
- Hepatitis A incidence is **seven times higher** than the international average²

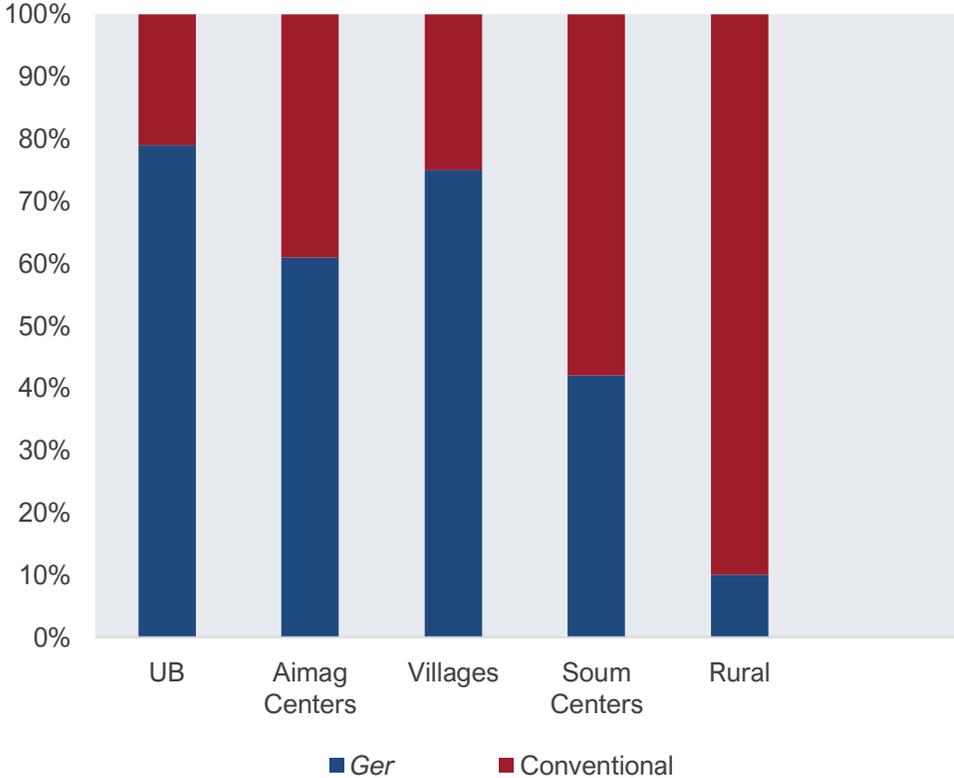
Rising food costs make it more expensive for parents to feed their children³

- **Increased malnutrition** of parents and their children. Some children only get to eat once a day³

Meeting Basic Needs: The Ger District

Housing Types by Census Category (%)

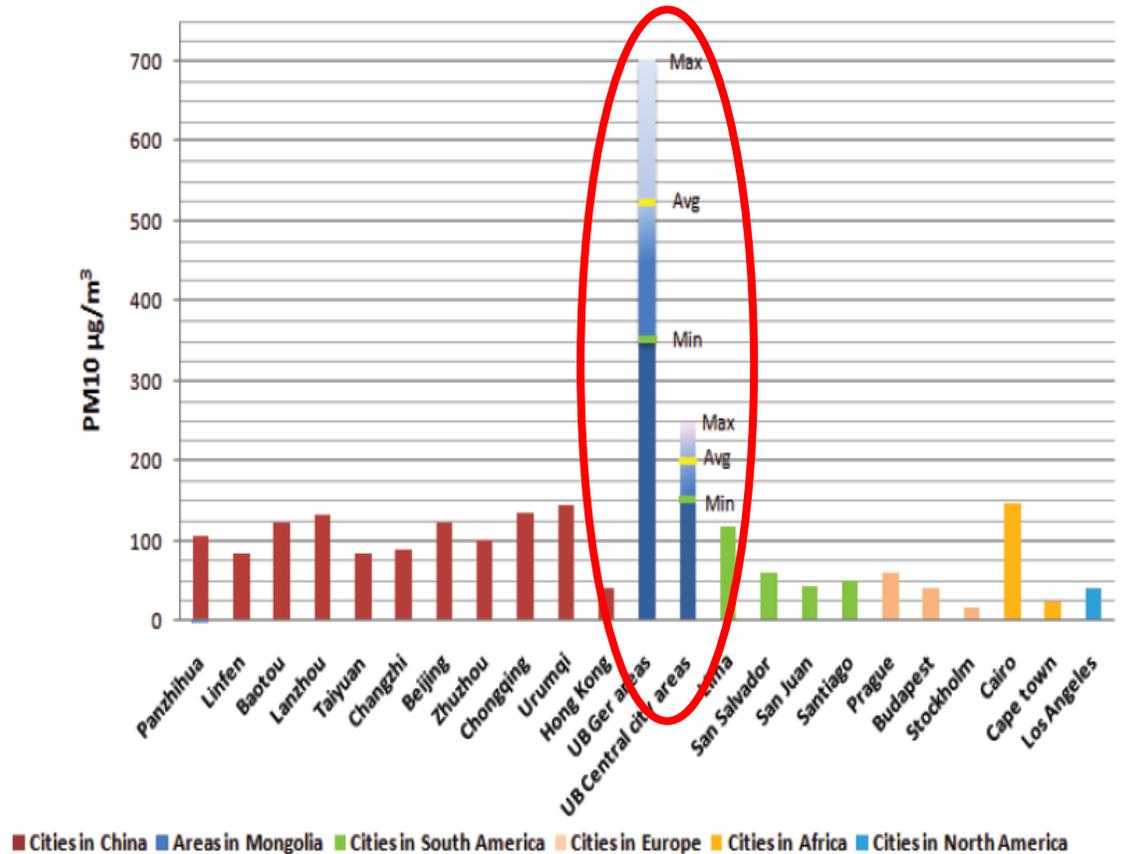
Ger districts in Mongolia house approximately **50% of the total population**. They have no basic sanitation and have poor heating facilities.



Environmental Issues: Air Pollution



Air in Ulaanbaatar shows the highest concentration of particulates



An Alternative Approach to Address these Needs

Direct cash pay-out to population?

- **Does not solve** underlying issues nor promote necessary investment

Government directed services?

- **Government may not be the best candidate** to fulfil all market and social needs

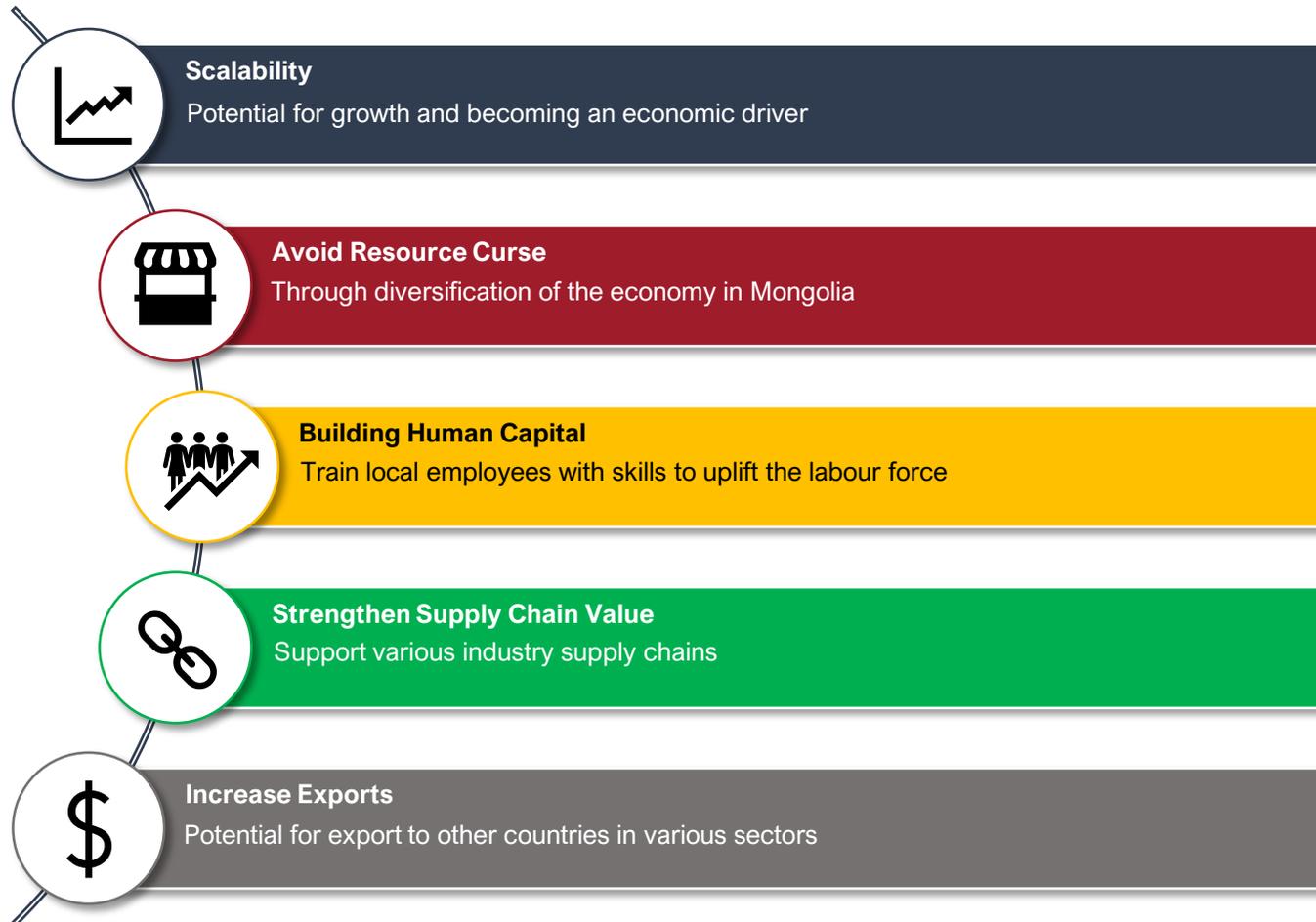
Building SMEs*?

- **Utilising private enterprises** to provide market and social needs as well as generating wealth for the population

*SMEs are defined as <199 employees and <MNT 1.5 billion sales as per 2007 SME law passed by the Mongolian Government

Utilising resources to build local SMEs may be the best approach to meeting the social, environmental and economic needs of the people

Why Support SMEs?



SMEs provide wider ripple effects through communities and create role models

Challenges Faced by Mongolian SMEs

From our research and interviews with local SMEs, we observed the following:

Lack of access to financing – high bank lending rates (Bank of Mongolia Policy Rate: 13.25%), combined with “missing middle” for SME funding

Limited collateral options accepted by banks, for example companies cannot borrow working capital against purchase orders

Loan tenors are too short for long-term investment needs of SMEs

Many SMEs are passionate about building Mongolia but obtaining funding from banks/funds is proving difficult

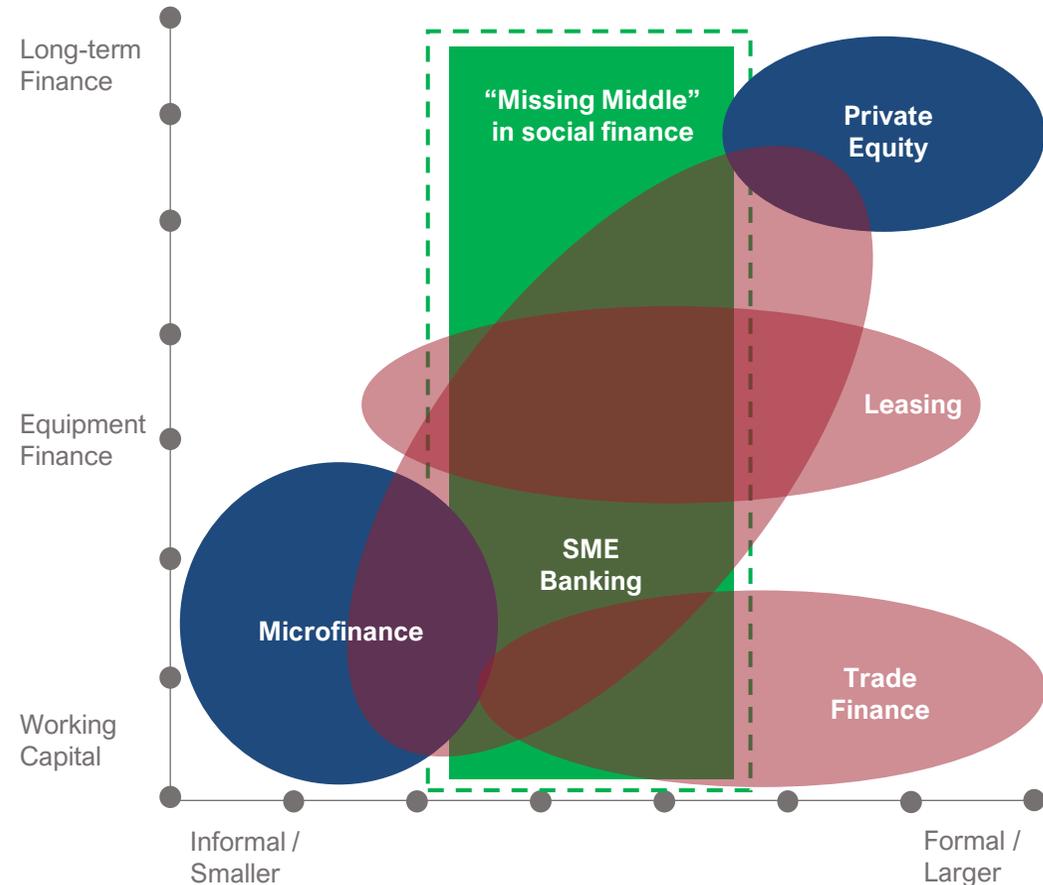
Weak capacity for market research/business planning²

Lack of skills in management, strategy, and accounting

SMEs face many diverse issues that need to be addressed before they can progress

SMEs Face the “Missing Middle” in Funding

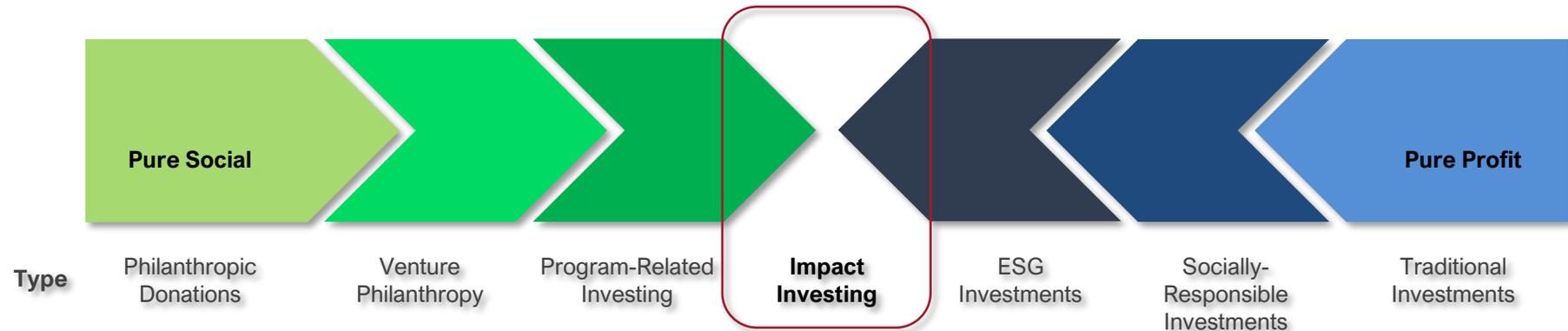
- There is a critical financing gap between the US\$ 500,000 to US\$ 3 million investment range.
- Below this financing range lies the realm of angel investing and microfinance; above it is government aid and private equity.



Source: Originated from International Finance Corporation; Modified by Advantage Ventures, 2011

Impact investing provides the necessary missing capital required for growth

What is Impact Investing?



Source: Advantage Ventures

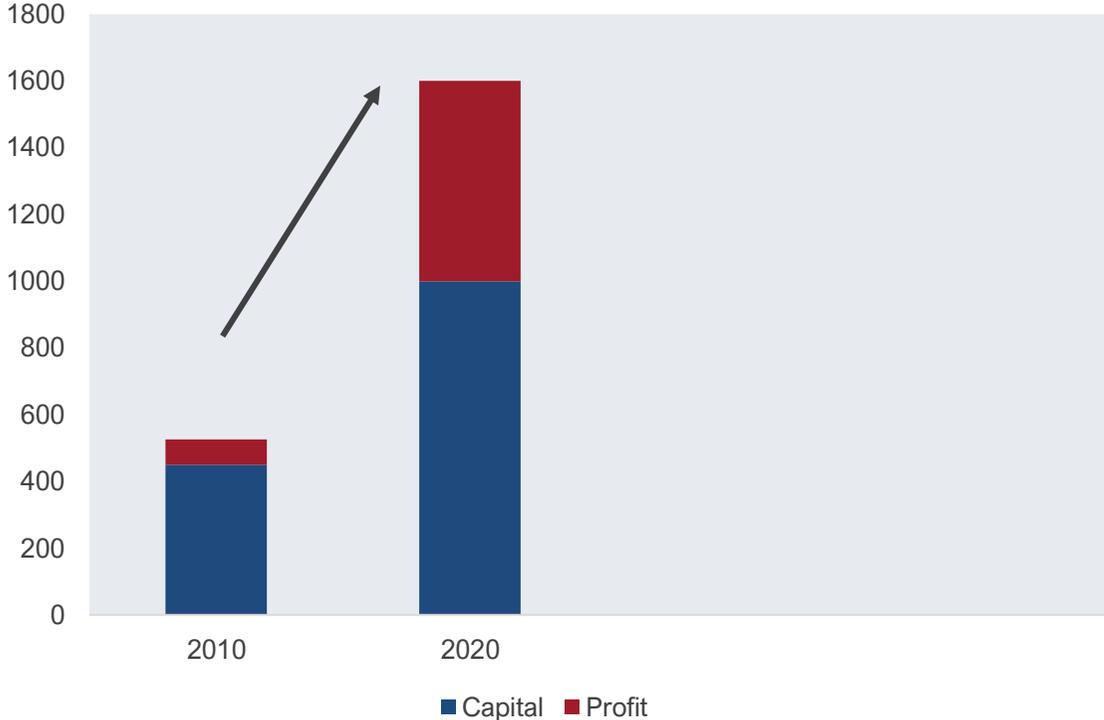
- Aims to fund the “Missing Middle”
- Must be profitable *and* improve the lives of the community
- Neither solely profit driven or solely philanthropic

Impact investing seeks to maximise both social *and* financial returns

Impact Investing Trends

The International Finance Corporation (IFC), which makes many impact investments, revealed their emerging market equity portfolio has outperformed traditional emerging market venture capital and private equity benchmarks for investment from 1989 to 2006.

Impact Investing is A Global Phenomenon



Source: JP Morgan Impact Investments report

Impact investing is expected to grow significantly over the next to 10 years from US\$400 billion to US\$1 trillion in invested capital

Impact Investing: The Potential for Driving Change

- Blends economic, social, and financial components into “total” returns
- Fills gaps left by traditional philanthropy, investment and government
- Provides an alternative source of funding, which potentially bypasses collateral and other constraints
- Allows SMEs to have access to professional management, planning, accounting, and financial expertise in order to grow the business
- May potentially take a longer term view on developing businesses and investments compared to banks and traditional PE funds



Impact investing can deliver blended value through patient and flexible capital



MEASURING SOCIAL IMPACT



Why Measure Social Impact?

What is **measured**, is **valued**. Measuring and communicating positive social impact gives assurance to investors and stakeholders that the fund is realising its intended results. Effective measurement can:

Create the basis for future fundraising and build investor confidence

Improve programme management through effective planning and evaluation

Increase understanding and transparency of impact investments

Strengthen communication of the value of the fund to 'the people that matter' (internal and external stakeholders)

Ensure fund managers are held accountable to social impact goals by having measurable targets

Enhance attention to social, economic and environmental value created by investments¹

Measurement Principles

Propose to measure social impact by selecting performance metrics, which are:



Photo Credit: Joseph Harrison

Source: Advantage Ventures

Measurement Metrics

Below are examples of measurement indicators that can be used to monitor progress:



Poverty

- % change in real wages of low income demographic
- % of employees coming from low income demographic or the “affected communities”
- Total hours of vocational training



Access to Basic Needs

- % of people from the affected community with access to improved drinking water sources
- % of people from the affected community with access to improved sanitation facilities
- % of underweight children under five years of age



Environmental Issues

- Healthcare cost of respiratory related diseases among children under 16 years old
- Number of school days lost due to respiratory related diseases
- % of change of surface water resources due to deforestation

Social Impact Metrics Used Internationally

Best Alternative Charitable Option (BACO) by Acumen Fund:

- Measures additional social impact of investment compared to equal amount of money donated to charity fulfilling similar social needs
- Strives to compare apples to apples using measurable metrics (e.g.: amount of low income families housed through investing in SME vs. donating same amount to affordable housing NGO)
- Projected BACO can be done before investment to assess business and updated regularly after investment is made to measure actual impact

Impact Reporting & Investment Standards (IRIS) by Global Impact Investing Network (GIIN):

- Developed to provide a common reporting language for impact-related terms and metrics. Standardises measurement of social and environmental performance
- Contains standardised metrics based on industry (agriculture, education, energy, environment, finance, medical, housing and water)
- Both quantitative and qualitative, however, metrics lack depth
- Metrics break down impact based on organisation, financial, operational impact, product impact, social policies, and others

Social metrics could be aligned with the UN Principles for Responsible Investment (PRI)

Case Study: *Ger to Ger**

Dundgobi



Training



Tourists



“Before we were involved in the Ger to Ger project, we did not have our own animals and we used to herd other people’s animals to feed our four daughters. We are very happy now to become members of Ger to Ger. We bought sheep, few cows and horses. We can even send our two daughters to University.”

Chuluuunhuu, Nomadic Herder

Applicable indicators:

- Increase in average household income of the involved community
- Total number of training hours and total number of people trained

Source: www.gertoger.com, “Ger to Ger – A Social Venture in Mongolia”

**Ger to Ger* is a travel enterprise which manages and promotes cultural GeoTourism initiatives of the nomadic herder groups in Mongolia.



FOCUS SECTORS

Aspirations of The Fund

Mongolia's growth vision:

- Diversified economic growth
- Human development
- Improve living standards

Social & economic reality

- Fast but imbalanced growth
- Prosperity vs poverty
- Heavily reliant on mining

Social impact goals of The Fund:

- Reduce poverty
- Meet basic needs of people
- Address environmental issues



Agriculture



Education



Affordable Housing



Healthcare



Waste Management



Mining Supply Chain

The proposed industry sectors are based on a careful balancing of the country's urgent needs with immediate social impact considerations

Agriculture: Market Background, Growth Opportunities

Current Industry Overview

- Agriculture accounts for around 20% of Mongolia's GDP and 35 – 40% of employment*
- Livestock accounts for ~80% of agricultural production, the rest are crops. Most of the livestock sector's produce is food
- The most lucrative business has been cashmere wool, the 2nd largest in the world after China*
- Meat and dairy products are the main remit of farms around UB with 85 – 95% of all meat produced being consumed domestically



Challenges

- Herd sizes are generally small, ~6% of herders have >500 head, 39% of them have <100 head*
- Most farmers are isolated and have very basic processing capability resulting in low value added products & wastage
- ~50,000km of roadways but over 46,000km (93.4%) are unpaved
- Lack of technology and facilities to preserve meat and dairy leads to significant waste. Estimates vary that 50 – 97% milk produced is wasted

(*) THE REPORT Mongolia 2012 by OXFORD BUSINESS GROUP

Huge opportunity exists to modernise agricultural processes and reduce waste

Agriculture: Commercial & Social Impact of The Fund

The Fund's Value-Add

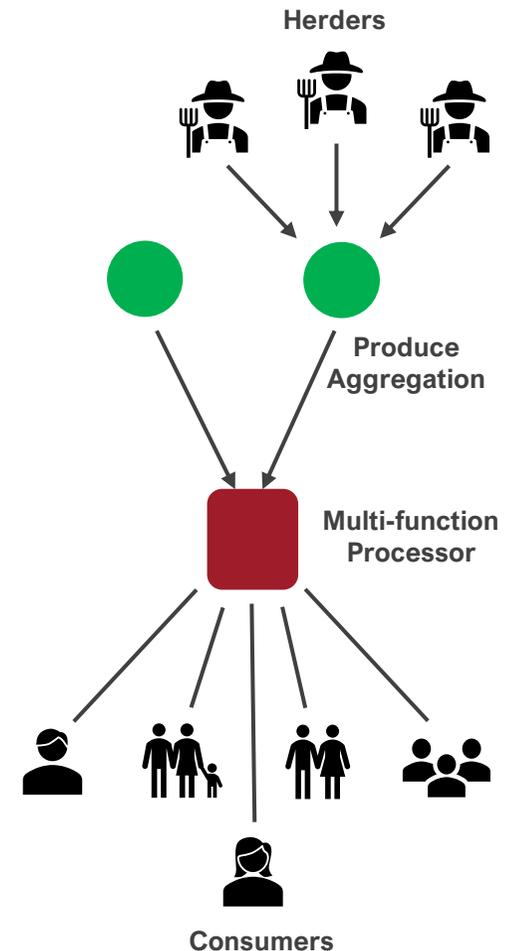
- Capital for possible scale-up, integration, technology upgrades and skill improvement
- Novel mechanism and approaches to enable changes across the industry value chain
- Leverage agricultural management know-how through fund's global network

Commercial Benefits

- Efficiencies through economies of scale in local production and possible industry integration could create a more sustainable production business
- Waste reduction through better processing of meat/dairy products and leather
- Increase exports to reduce dependence on mining

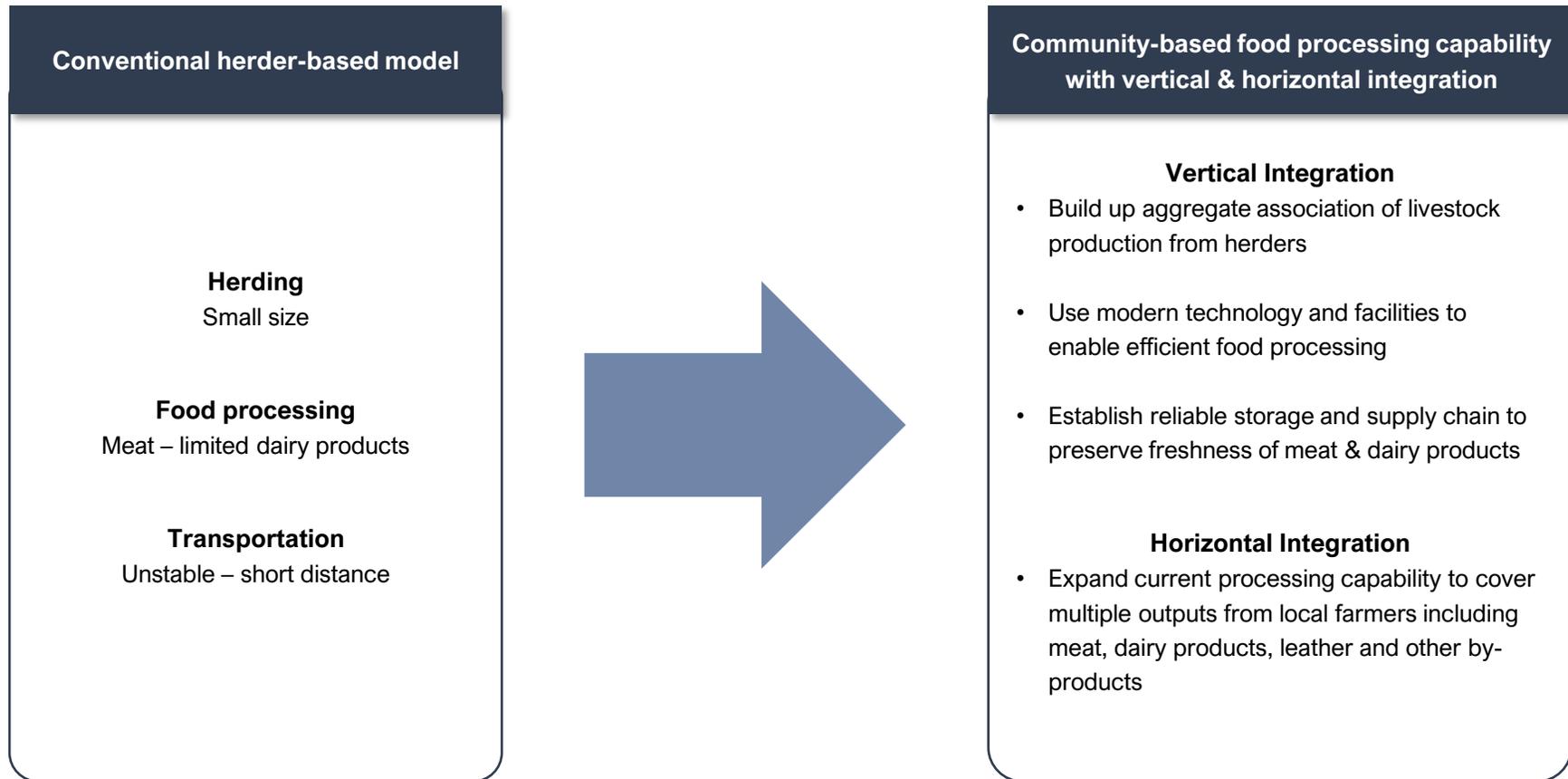
Social Impact

- Food security and safety
- Increase income for herders
- Create employment through increased processing
- Technology transfer in processing & supply chain



Capital and know-how can bring a new face to the local agriculture industry

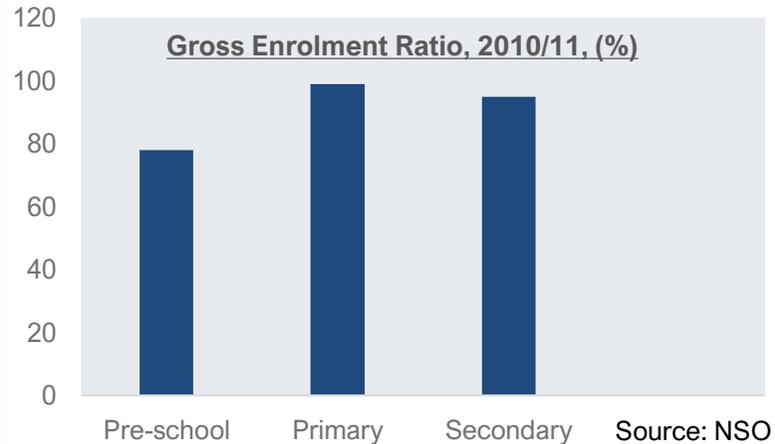
Agriculture: Potential Business Model for Investment



Changing existing structure and supply chain can significantly improve efficiency

Education: Market Background, Growth Opportunities

Current Education Overview



- Basic education is widely accessible
- 178 colleges and universities, of which 42 are public



Surging Needs in The New Era

- Recent explosive growth in industry sectors such as mining has driven demand for skilled labour
- Existing education system lacks capacity to provide vocational training to meet this increase in demand
- It is estimated that 30,000 people annually need urgent training for immediate employment needs, especially in mining and construction sectors

Education: Commercial & Social Impact of The Fund

The Fund can provide

- Capital to establish training facilities, materials and educators
- Academic, technical and vocational know-how through a global network
- Management and capacity building to run a first-rate educational institute

Commercial Benefits

- **Provide for growing industries**
 - Skilled and experienced workforce
 - Stable labour supply
 - Customised and skill-based training
- **Return to the service providers**
 - Service fees for training, recruiting and workforce management
 - Premiums on expertise, customisation and hassle-free one-stop-shop service

Social Impact

- Improve the labour force's vocational skills
- Reduce unemployment
- Improve income
- Enhance knowledge transfer
- Inspire more creativity and entrepreneurship
- Improve social stability

Education: Potential Business Model for Investment



- **Labour recruiting**

Reach out to rural and urban areas to recruit people who want to get employed, thus promoting the mindset for skill development

- **Vocational training**

Plan with companies and partners to understand specific training needs, develop training programmes and train people

- **Workforce contracting**

Provide skilful workforce for companies and partners on a long-term basis and manage attrition rates

- **Workforce management**

Provide all the above services as well as consultancy and planning for customers on HR management

Healthcare: Market Background, Growth Opportunities

Per capita total expenditure on health is low in comparison with regional average



Low life expectancy

- Men's life expectancy is low in comparison with regional average
- Under-five and maternal mortality ratio is high
- Adult mortality rate is very high in comparison with global average



Quality and capacity of facilities & equipment

- Many health centres would not be defined as such in Western systems
- Many small local clinics have only handful of inpatient beds



Regional disparity

- While Ulaanbaatar has a ratio of one doctor for every 248 people, the Western region has less favourable statistics, with one doctor for every 616 people



Human resources

- Little opportunity to participate in training programmes to obtain new knowledge and technologies

Healthcare: Ideas for Impact Investment

	Activities	Potential Business Model
Equipment play	<p>Providing facilities and equipment</p> <ul style="list-style-type: none">• Establish new hospitals, clinics, etc• Provide medical and other equipment	<p>Capital leasing</p>
Education	<p>Training doctors and medical support staff</p> <ul style="list-style-type: none">• Establishing world-class programmes nationwide	<p>Professional and vocational training</p>
Community service	<p>Disease prevention</p> <ul style="list-style-type: none">• Immunisation, health check, preventive medicine, giving information to citizens about personal / family healthcare <p>Promoting hygienic environments</p> <ul style="list-style-type: none">• Maintaining infrastructure such as sanitation and water	<p>Integrated real estate development project</p>

Affordable Housing: Market Background, Growth Opportunities

Government Policy

- Launched the **100,000 Housing Construction Policy** in 2011 to address critical systematic deficiencies in housing finance and affordability



Market Background & Growth Opportunities

- City population has increased by 60% over the last decade
- Estimated 170,000 families settled in the *Ger* district
- Average cost of affordable housing is US\$ 31k – US\$ 43k
- Less than 20% of home owners have mortgage loans

Challenges

- Lack of skilled and experiential workforce for construction
- Lack of infrastructure
- Construction materials are mainly imported
- Low income families cannot afford to purchase a home and/or lack access to financing
- No institutional systems to provide low-cost housing for middle and low-income households

Government policy alone may not fulfil the housing needs of the people

Affordable Housing: Social / Environmental Considerations



Affordable Housing: Ideas for Impact Investment

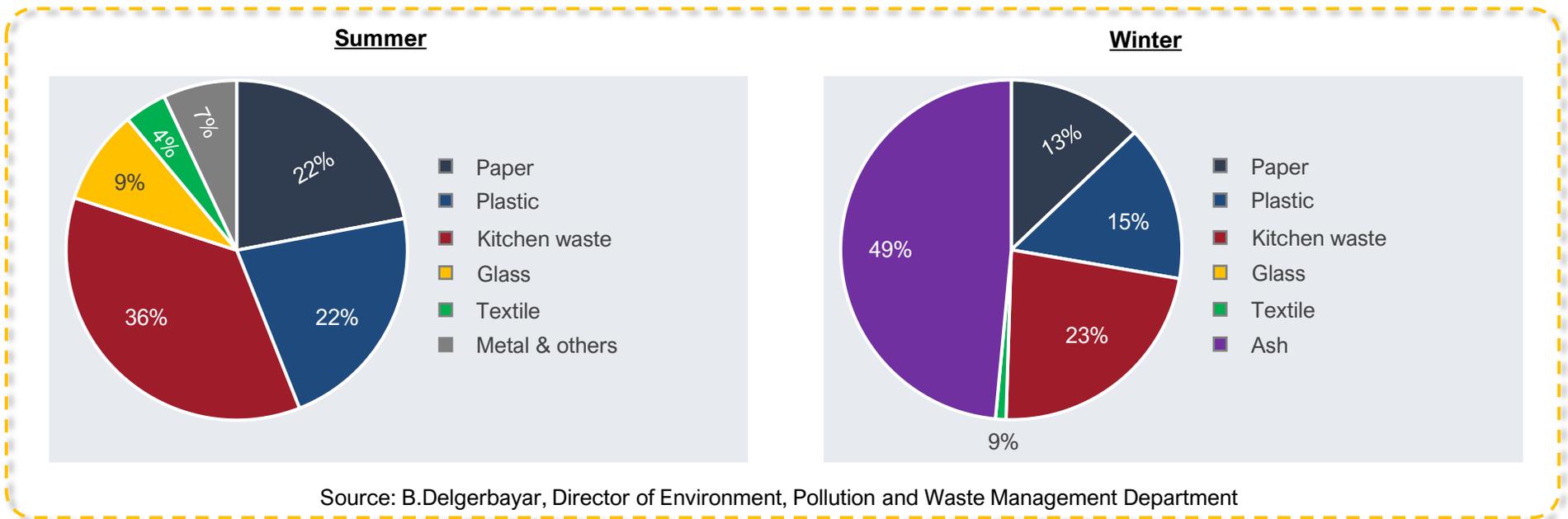
	Activities	Potential Business Model
Equipment play	<ul style="list-style-type: none"> Organise building equipment: Provide cost effective equipment and related maintenance and service 	<ul style="list-style-type: none"> Capital leasing Equipment leasing Sub-contracting
Material play	<ul style="list-style-type: none"> Produce good quality and low cost building material locally Introduce green building material 	<ul style="list-style-type: none"> Production investment Material trading
Training	<ul style="list-style-type: none"> Provide profession and vocational training to construction workforce, such as architects, engineers and operators 	<ul style="list-style-type: none"> Professional and vocational training
Construction contractor	<ul style="list-style-type: none"> Utilise most efficient construction technology, know-how and management systems 	<ul style="list-style-type: none"> Technology transfer
Property development	<ul style="list-style-type: none"> Develop real estate projects with a good balance of profitable portfolio and low income housing products 	<ul style="list-style-type: none"> Specialist developer
Financing	<ul style="list-style-type: none"> Provide financial resource to preferred developers who meet social impact requirements Provide financial resource to supply chain parties Provide special mortgage through financial institutions to low income families with conditions 	<ul style="list-style-type: none"> Equity and debt investment

Waste Management: Market Background, Growth Opportunities

On average, 210 – 260 thousand tons of waste per year is being disposed in Ulaanbaatar

- Apartment residents generate approx. 0.0235kg/day
- Ger area residents generate approx. 0.0956kg/day

The type and quantity of waste generated varies by season. During the summer, more waste is generated due to construction and during winter, it is due to ash from burning wood, coal, paper and cardboard.



Impact investing in waste management is crucial to the well-being of Mongolia

Waste Management: Potential Areas to Explore Further

Current Waste Management Capacity

Water

- Approx. 100 water treatment plants processing about 130 million m³ per year – less than half the waste generated

Vehicles

- Over 200,000 registered cars with 50% over 11 years old and 30% from seven to ten years old

Solid Waste

- Eight open dumpsites and no waste paper treatment plant

Ash

- *Ger* households burn 200,000 tons of coal and 160,000 m³ tons of wood annually. Waste is dumped on the streets

Challenges

- Lack of capital to conduct feasibility studies and to establish waste processing plants
- Limited access to technology
- Need for trained workers to manage collection and disposal of waste
- Absence of a system to collect and process waste, e.g. collect and process ash from the *Ger* district

Source: Municipal Waste Management Report: Status Quo and Issues in Southeast and East Asian Countries (AIT/UNEP RRC.AP)

Mongolia, Environmental Health Country Profile (WHO)

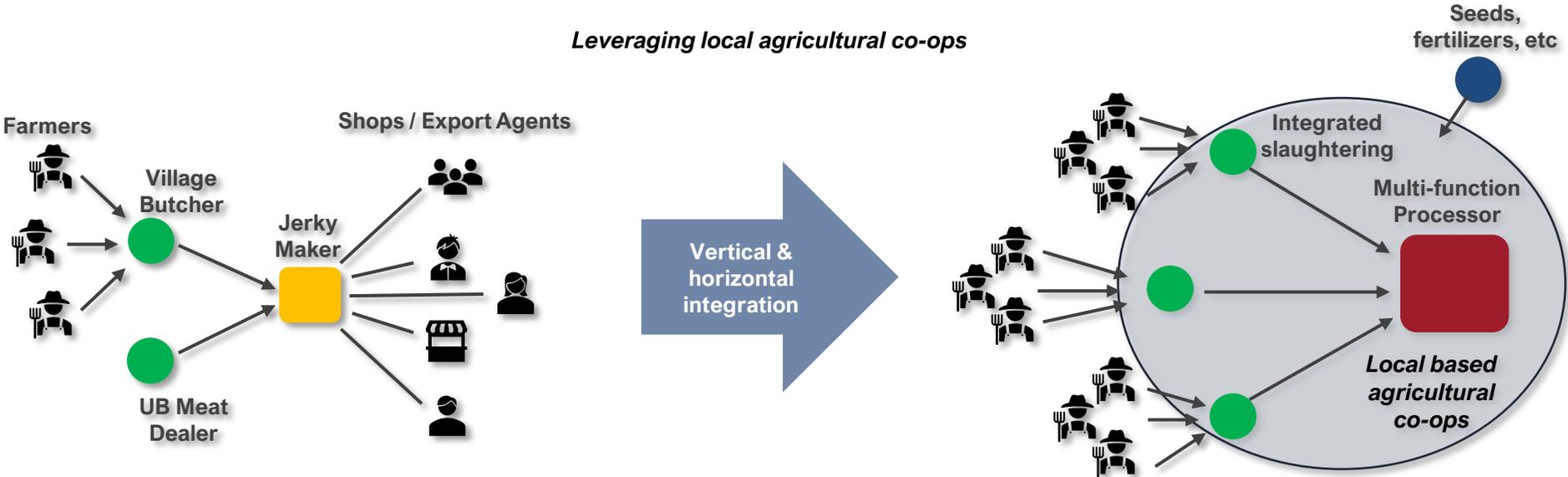
Managing Wastes in Asia: Looking at The Perspectives of China, Mongolia and the Philippines (Kevin Roy Serrona, Jeong-soo Yu and Jia Che, Department of Interregional Environmental System, Graduate School of International Cultural Studies, Tohoku University)

Snapshot of Investment Pipeline

	Key Social Impacts	Typical Company Size	Possible Investment Size	Priority for Investment Consideration
Intensive agriculture	<ul style="list-style-type: none"> Farmer income Employment 	US\$ 0.5 ~ 1M	US\$ 2 ~ 5M	High
Vocational training	<ul style="list-style-type: none"> Skills Employment Worker income 	US\$ 0.2 ~ 0.5M	US\$ 0.5 ~ 1M	High
Healthcare	<ul style="list-style-type: none"> Livelihood 	US\$ 0.2 ~ 2M	US\$ 0.5 ~ 5M	Medium
Affordable housing	<ul style="list-style-type: none"> Living condition Sanitation Environment 	US\$ 1 ~ 10M	US\$ 5 ~ 20M	Low
Waste management	<ul style="list-style-type: none"> Environment 	TBD	TBD	Medium
Mining supply chain	<ul style="list-style-type: none"> Employment 	TBD	TBD	TBD

Potential Pipeline Candidate: UB Beef Jerky Producer

Leveraging local agricultural co-ops





ASSESSMENT CRITERIA

Overview and Fund Ethos

Overview

The following assessment criteria have been carefully chosen to aid the investment screening process, ensuring that The Fund achieves its objective of **blended value**: the maximisation of both social and financial returns in our chosen sectors

Fund Ethos



Competitive returns on investments and making a positive impact on society and environment are not mutually exclusive



Businesses can – and should – profit from delivering social and environmental good and profits could be reinvested in social impacts

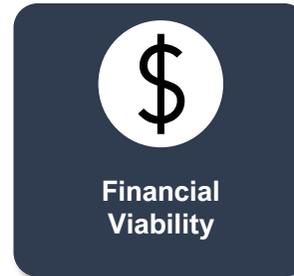


The Fund will commit itself to upholding the highest professional and ethical standards

Finding an alternative to philanthropy and purely commercial investments

Assessment Categories

The business should achieve investors' desired financial returns through excellence:



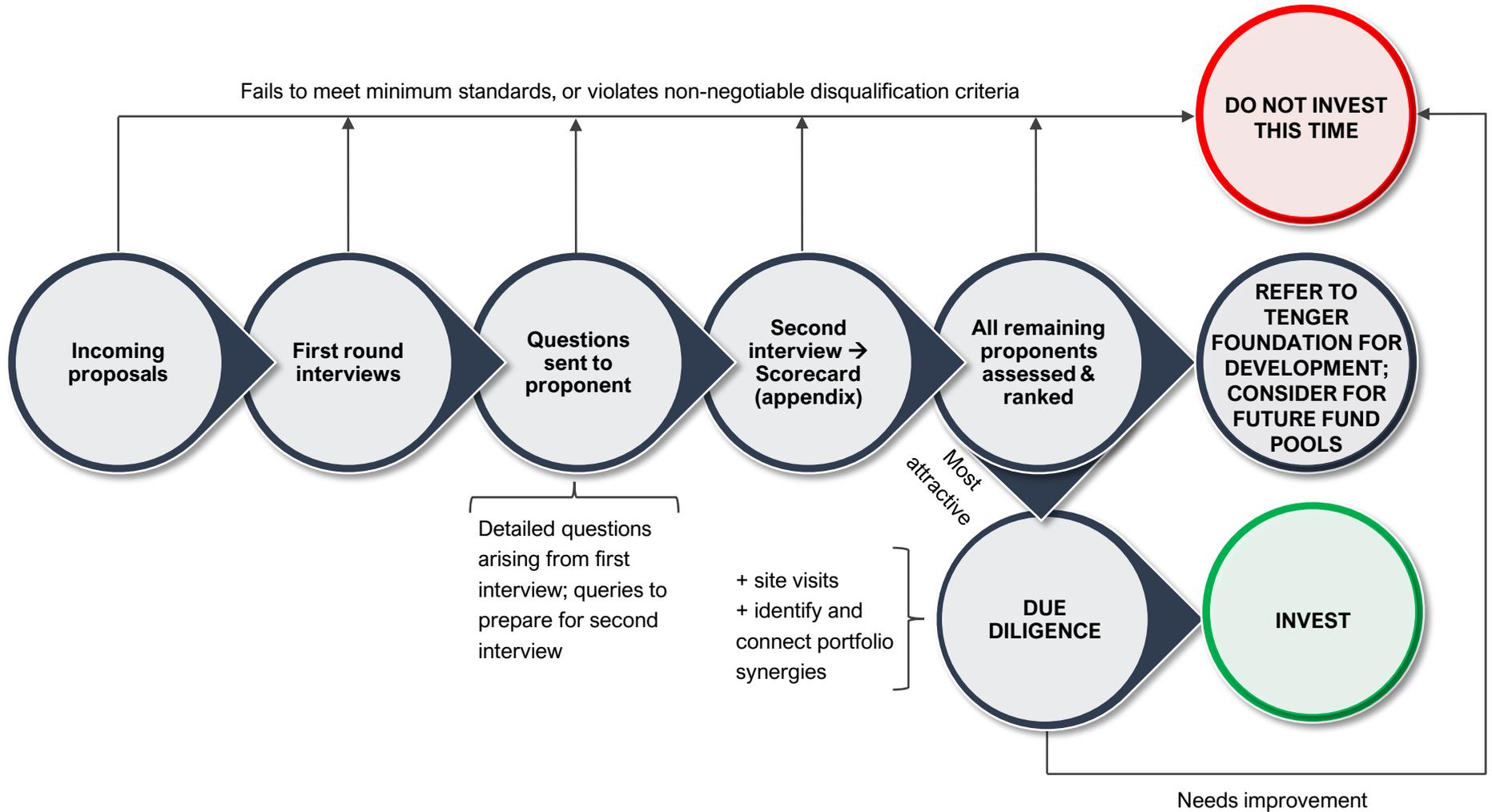
It should also have a measurable positive social impact on:



Ideally, the business model should have high:



Assessment Process



Assessment Criteria: Financial Viability



Current Financial Performance

- Ensure availability of financial data and assess the following factors:
 - Profitability
 - Cash flow / liquidity
 - Debt repayment capacity and collateral sufficiency
- Assessment to be made based on audited financial statements where applicable
- Perform cash flow analysis based on bank statements, should audited financial statements not be available – as is the case for many SMEs

Future Financial Performance

- Business investment plan
- Revenue and cash flow projections including sensitivity analysis on various factors (demand fluctuations, currency fluctuations, etc.)

Financial benchmarks and other assessment criteria will differ based on industry, portfolio balance at the given time, potential social impact, and other factors determined by the Fund Manager

Assessment Criteria: Financial Viability

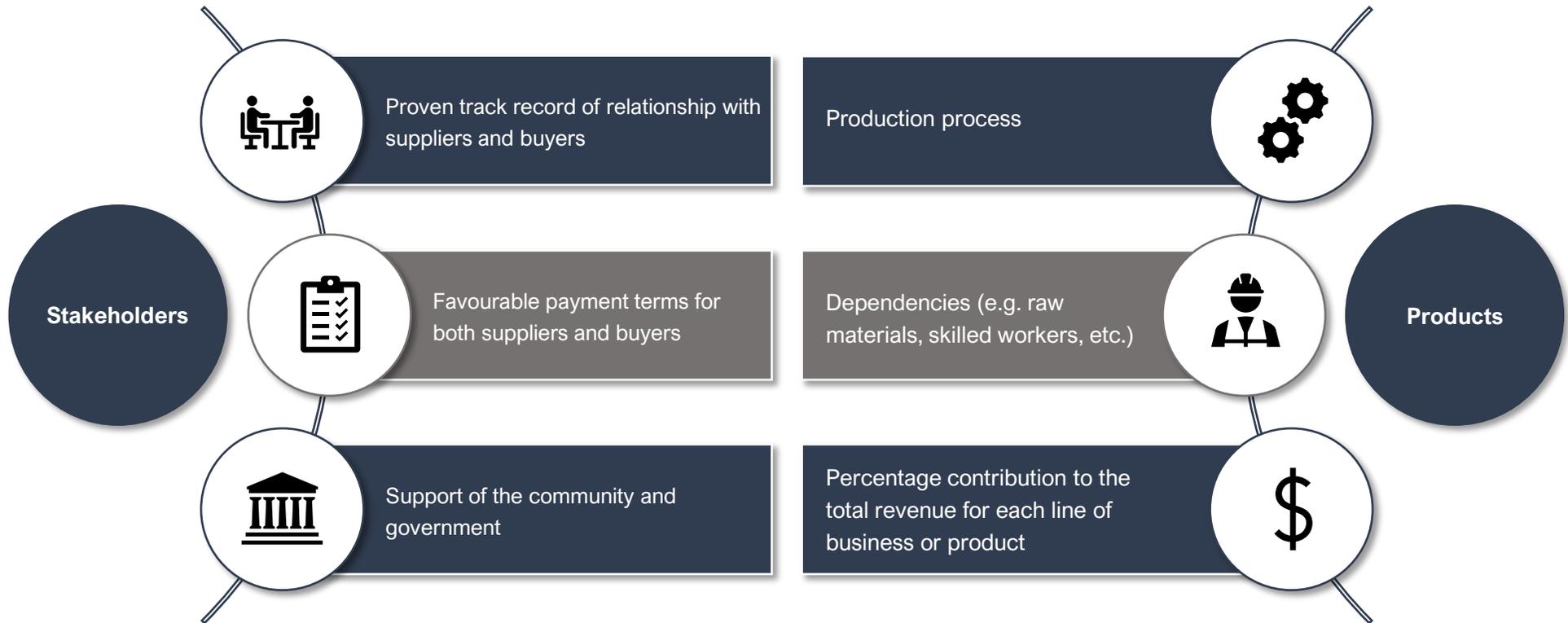


Sample of the financial assessment scorecard*

Sub category		Proposed Indicator	Poor	Modest	Satisfactory	Good
Current Financial Performance	Efficiency	EBIT margin (%) *EBIT = Earnings Before Interest, Taxes	< 0%	=< 0%, <8%	=< <8%, < 16%	16% <=
		EBIT on Tangible Assets (%) *Tangible Assets = Total Assets – Intangible Assets	< 0%	=< 0%, < 6%	=< 6%, < 12%	12% <=
	Financial Policy	Debt / Capital (%)	> 85%	50% =<, < 85%	30% =<, < 50%	< 30%
		Debt / EBITDA (x times) *EBITDA = Earnings Before Interest, Taxes, Depreciation and Amortisation	> 6x	3.5x =<, < 6x	1.75x =<, < 3.5x	< 1.75x
	Financial Strength	EBIT / Interest (x times)	< 1.5x	1.5x =<, < 4x	4x =<, < 9x	9x =<
		Cash from Operation / Debt (%)	< 5%	5% =<, < 20%	20% =<, < 40%	40% =<
		Free Cash Flow / Debt	< 0%	0% =<, < 6%	6% =<, < 18%	18% =<

Assessment Criteria: Financial Viability

It is important to build strong relationships with key stakeholders, as they will have significant impacts on business.



Suppliers, buyers and operational issues can significantly impact growth

Assessment Criteria: Management & Governance



Management & Governance

- Management structure should be effective and sustainable
- Adequate measures should be taken from a Corporate Governance standpoint on issues such as tax adherence, labour laws, environmental standard, etc.
- For sole proprietor, a clear succession planning and delegation of authority
- For joint ventures, clear management and ownership structures
- Decision makers (proprietor or manager, whichever is applicable) should be qualified and experienced

Legal Environment

- Ownership of necessary business licenses
- Robust legal environment preferred for developing SMEs and allowing foreigners to participate in the development of the economy by bringing in capital

Public Engagement

- Level of business consultation with local communities
- Community participation in decision making of key business activities
- Level of willingness to engage with regulators to raise social and environmental standards

Assessment Criteria: Social Impact



Assessing social impact of different SMEs that serves different needs means using different social metrics

Social metrics are unique to each industry/business as many will not cover all aspects of social impact (e.g. sanitation company may have little impact on poverty alleviation)



Potentially hard to consistently find SMEs with both high financial and social returns, therefore Fund Managers should have discretion to choose investments as long as there is some form of minimum social/financial targets

Portfolio may contain SMEs with high financial return with low social return or vice versa, overall portfolio should be balanced



Minimum floors should be set for both financial and social returns

Assessment Criteria: Poverty Alleviation



Broader than measuring only the number of people 'below the poverty line', the following criteria (based on the Human Development Index metrics) assess SME contributions to alleviating poverty in Mongolia



Income

- New employment and improved wages – especially for low-income group



Life Expectancy

- Improved health and well-being for people in the community



Education

- Deliver education and vocational skills to local communities



Use of Local Resources

- Establish local supply chains to provide for businesses
- Promote energy independence and domestic food security



Source: Human Development Index, UNDP, 2011: <http://hdr.undp.org/en/statistics/hdi/>

Investments contribute to Mongolia's Human Development

Assessment Criteria: Meeting Basic Needs



The following criteria will be used to assess whether the SME contributes to the fulfilment of basic needs:

Basic Needs Assessment	Less	Fit	More
Number of low-income beneficiaries	150 or less	150 - 250	500 or more
Level of social goods/services to fulfil basic needs	Destructive practices	No harmful practices	Good social / environmental practices
Type of social impact	Indirect	Direct	Both
Timeline of impact	Long term (Education)	Medium term	Immediate (Income generation)

The Fund empowers the most disenfranchised groups

Assessment Criteria: Environmental Issues



SMEs will be assessed for performance in each of the following environmental priorities:

Pollution reduction or prevention

Air, water, soil

Resource conservation

Water, forests, grassland

Protecting sensitive ecosystems and species

Biodiversity

Material waste management

Greenhouse Gas (GHG) emissions



Protecting our shared environment and reducing our footprint

Assessment Criteria: Potential for Scale/Replication



Scale

- Business that can achieve economies of scale but are constrained due to lack of access to additional growth capital and know-how



Replication

- Ability to standardise businesses that can be replicated in a reliable manner, producing quality products and services, across the country
- Diversify any supply chain risk without impacting cost structures and quality



Priority should be given to businesses with potential for scale and replication, which would result in greater potential for financial and social impact growth

Businesses should be scalable and replicable in similar environments



THE FUND

Fund Summary

Summary	
Target Size	US\$ 50 ~ 70 million (US\$ 100 million hard cap)
General Partner Commitment	10% of Fund size (US\$ 5 ~ 7 million)
Asset Classes	<ul style="list-style-type: none"> • Debt: Long term loans, subordinated loans (Mezzanine Debt) • Equity and Hybrid Equity (Convertible Debt)
Tenure	<ul style="list-style-type: none"> • 10 Year Term with Annual Extensions by Majority LP Vote • 5 Year Investment Period
Target Returns	<ul style="list-style-type: none"> • Net Internal Rate of Return (IRR) 10 ~ 15% • Hurdle rate: 8% + Social metrics achieved
Fees	<ul style="list-style-type: none"> • Management fees: Budget Based & Reviewed/Agreed Annually • Carried interest: 20% • 10% of Net Carried Interest Dedicated to the Foundation
Diversification	<ul style="list-style-type: none"> • Maximum of 15% of Fund in any one investment • Maximum of 25% of Fund in any one sector
Limited Partner Rights	Co-investment option in deals over US\$ 3 million

Mongolia's First Social Impact Fund

Commercially oriented, aligned interests & open for business

- Fund size of **US\$ 50 – 70mm; US\$ 100mm cap**
- Targeted returns of **10 – 15% IRR**
- GP commitment of **US\$ 5mm**
- Focus on SMEs

Driven at its core by key social impact principles

- **Promote SMEs delivering positive social & environmental impact**; Agriculture, Vocational Education, Affordable Housing, Healthcare & Waste Management

Targeted at specific social needs in Mongolia

- Drive **real, measurable social impact** in Mongolia
- Vocational training, technology transfer, best practice sharing
- Support an entrepreneurial culture & equity mindset

Experienced, professional sponsor & team

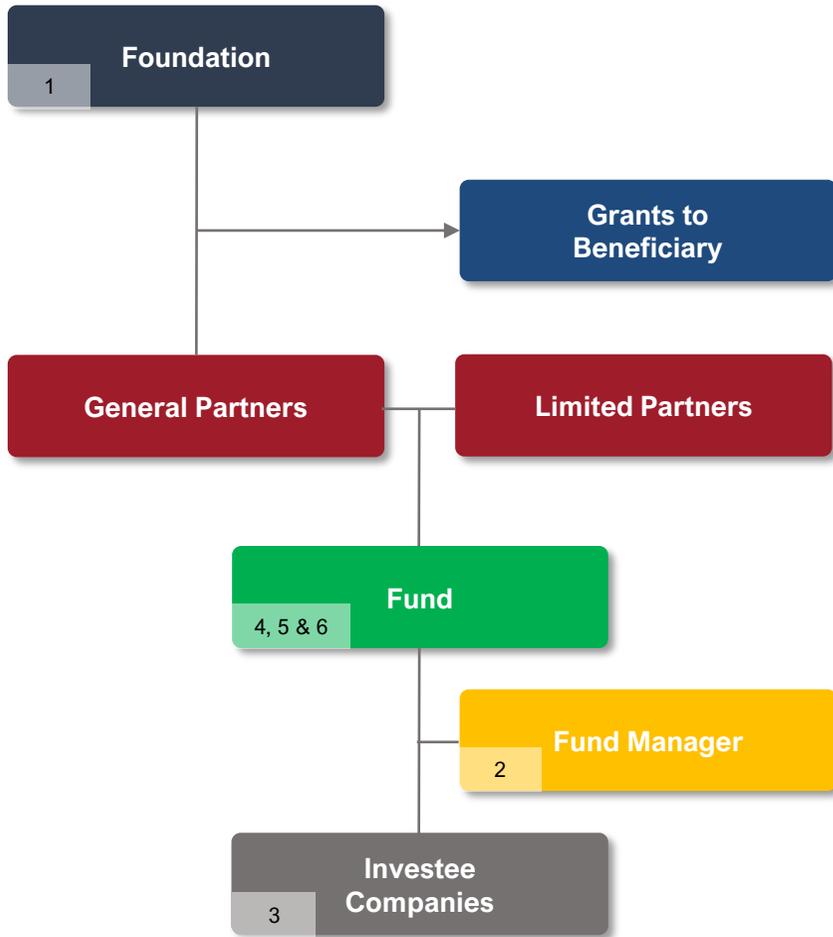
- Clear vision for a sustainable Mongolia
- **Proven track record** in private equity, fund management & social impact
- Extensive local deal sourcing networks & operational expertise

Sustainable advantage

- Limited competition, better pricing & more opportunity, as other funds centred on mining
- Demonstrate to policymakers & investors that social impact investing is real & viable
- Attract like-minded investors who are mission-aligned: *'doing well by doing good'*

Fund Structure: Improving the Traditional PE Model

OVERVIEW

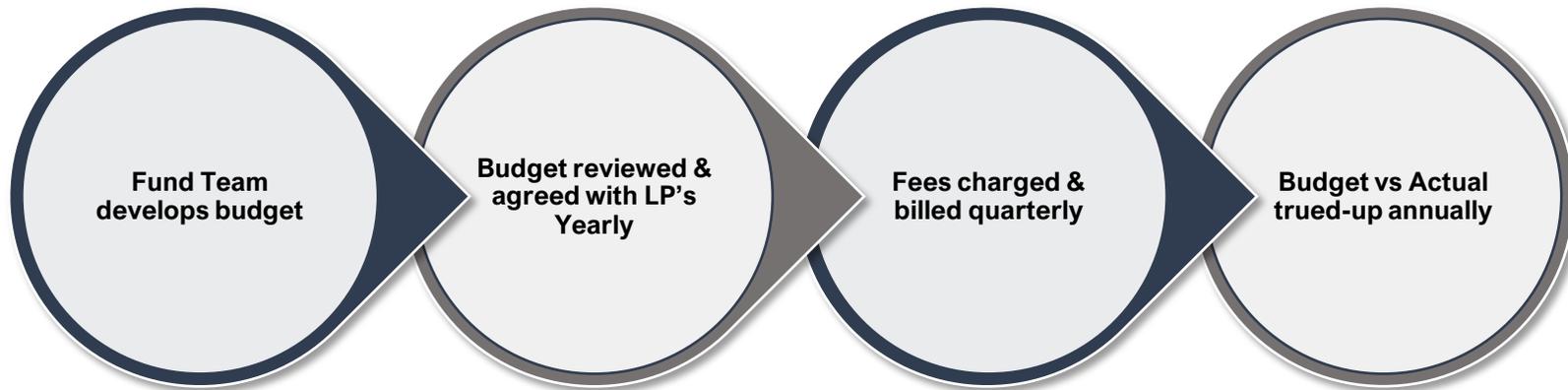


Traditional		Improvements
Purely profit focused	1. Incentives	Holistic view capturing externalities & social impact; Creation of GP funded foundation
Misaligned profit center	2. Fees	Budget-based transparency
Financially focused	3. Engagement	Broad-based: technology transfer, vocational training & development
Artificially imposed by fixed investment period & fund life	4. Timeline	Patient Capital. Derived from the underlying opportunity in the core business
Creation of jobs; expand tax-base	5. Impact	Improve the human conditions in Mongolia through commercially viable activity
Comprised of financially oriented representatives	6. Investment Committee	Broad-based stakeholders with diversified expertise (e.g. non-profit)

Fund Structure: Improving the Traditional PE Model

FEES: Aligning interests with Budget-based Fees

Aligning GP/LP Interests around Value Creation



- Aligns GP and LPs around fees and expenses
- Concentrates focus on true value added and value creation
- Acknowledges start-up fees are generally higher than ongoing fees and expenses

Budget-based management fees enables a true alignment of interest

Fund Structure: Improving the Traditional PE Model

ENGAGEMENT: Partnerships to Drive Impact

Maximise The Reach of The Fund's Impact

Accounting & Tax

- Explore partnership with top accounting firms for due diligence, accounting, tax and portfolio company CFO services.

Legal & Advisory

- Develop relationships with major law firms. Negotiate pro-bono and public service contracts for reduced rate services.

Deal Sourcing

- Leverage networks of suppliers, customers, bankers, multilaterals, etc. to drive deal flow.

Technology Transfer & Vocational Training

- Develop relationships with universities, training institutes, development/aid organisations (USAID) to provide a higher standard of care, development and nurturing for investments.

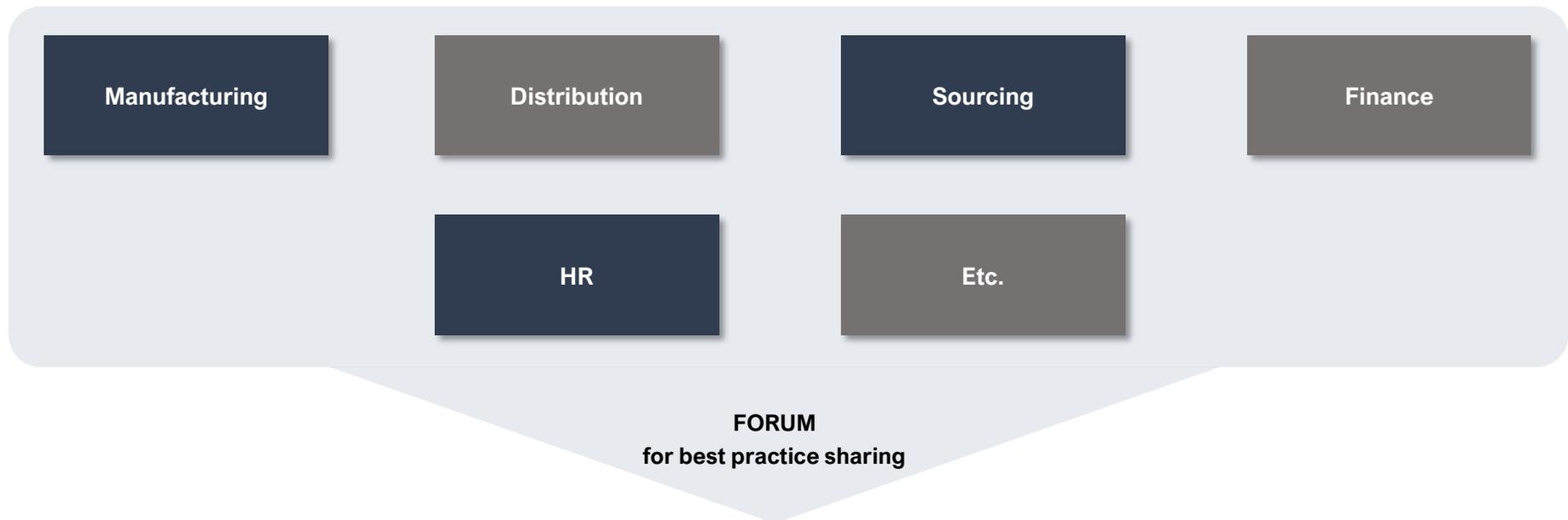
Social Impact

- Partner with GIFT to develop, implement, monitor and publish social impact metrics for the Fund and its portfolio.

Fund Structure: Improving the Traditional PE Model

ENGAGEMENT: Creating a Consortium of Investee Companies

Create A Self-Reinforcing Ecosystem for Best Practice Sharing

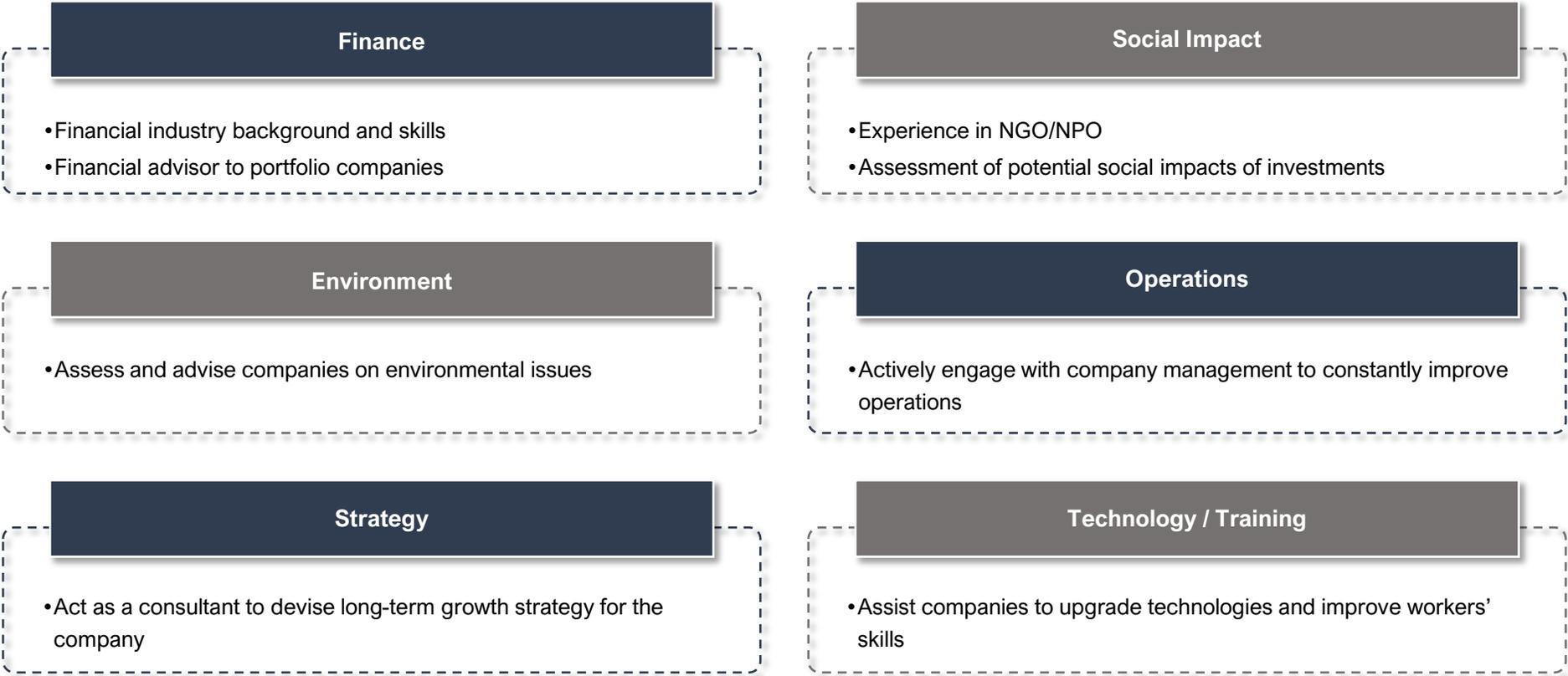


- Leverage the power of the network
- Best practice sharing across teams
- Cross-pollinate relative strengths/capabilities
- Forum for sharing ideas and resolving issues

Fund Structure: Improving the Traditional PE Model

INVESTMENT COMMITTEE: Rethinking the mix

Broad-based Stakeholder Representation – Ensure Social Impact is Integral to The Investment Process



The Fund will Adopt Best in Class Governance

Broad Recognition & Adoption of “ILPA” Private Equity Principles for GP/LP Partnerships

Alignment

- Carry/Waterfall
- Management fee and expenses
- Term of fund
- Fee income offsets
- GP commitment
- Standard for multiple product firms

Transparency

- Management and other fees
- Capital calls and distribution notices
- Disclosure related to the General Partner
- Risk management
- Financial information
- LP information

Governance

- Team
- Investment strategy
- Fiduciary duty
- Changes to The Fund
- Responsibilities of the LPAC

Creating an impact investing gold standard in Mongolia

Five Key Areas of Governance Focus

Team

- Strict time & attention standard
- Strict key man provisions
- Immediate notification of changes to LPs

Investment Strategy

- Strictly defined in the context of *Social Impact*
- Broad product definition to provide highest impact
- Clear carve-outs & restricted sectors

Fiduciary Duty

- Prompt & detailed conflict disclosure
- High standard of care
- Annual external audit

Fund Changes

- Amendments require 50% LP majority vote
- Termination of Commitment Period: 2/3 majority vote
- Termination of Fund: 3/4 majority vote

LPAC Responsibilities

- Address & resolve conflicts
- Platform for ongoing LP/GP dialogue
- Conduit for disseminating information

The Tenger Foundation: An Option for Consideration

Rationale

- Demonstrate a higher level of commitment of delivering real social impact in Mongolia via a wide range of capital including grants

Funding & Set-up

- Initial funding of US\$ 0.5 – 1MM
- Supported by 10% of Net Carried Interest from GPs
- Separate governance board

Use of Proceeds

- Support schools, hospitals and clinics in village areas directly connected to investee companies
- Make investment, provide grant capital and provide technical support to small firms that may create future Fund opportunities

Benefits

- Create a virtuous circle of positive impact, publicity and reinforcement for Fund activities
- Create a deeper level of engagement and benefits for firms, communities and investors

Exit Strategy and Target Returns

Fund Tenure **10 YEARS** Target Returns **Net IRR 15 ~ 20%**

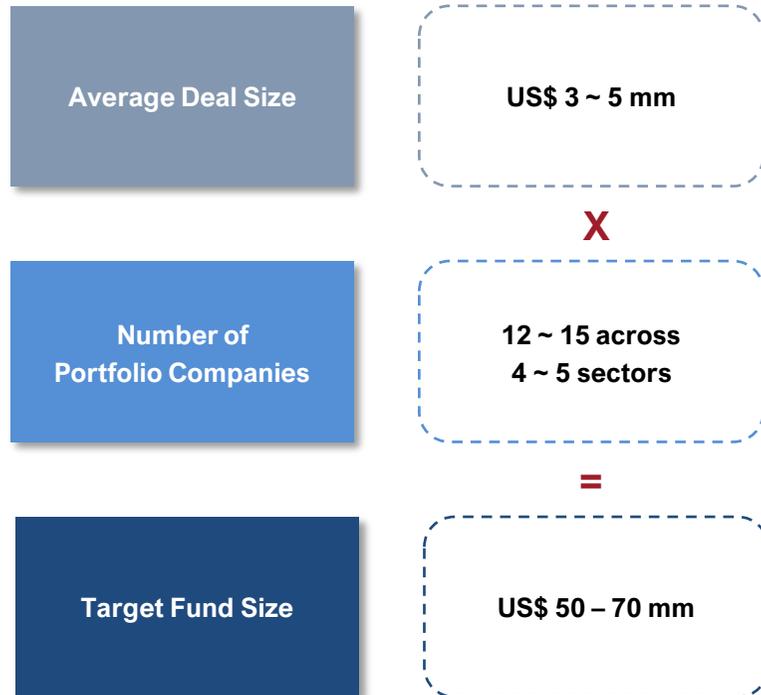
Exit Strategy	Financing Instrument	Duration end Exit Options	Implications for Social Enterprises
	Long-term loans	<ul style="list-style-type: none"> • Duration: 3 to 5 years • Exit: Interest and Principal repayment 	<ul style="list-style-type: none"> • Access to long-term capital based on future cash flows • No dilution of ownership
	High risk long-term loans (Mezzanine)	<ul style="list-style-type: none"> • Duration: 3 to 7 years • Exit: Interest and Principal repayment 	<ul style="list-style-type: none"> • High entrepreneurial flexibility in the use of capital • Flexible repayment terms
	Equity	<ul style="list-style-type: none"> • Duration: 5 to 10 years • Exit: <ul style="list-style-type: none"> • Buyback of shares by management • IPO on Mongolian Stock Exchange • Sale to strategic investor 	<ul style="list-style-type: none"> • Flexibility in raising further debt due to increased equity base • Option to buyback shares in the future to retain ownership • Access to experienced directors
	Hybrid Equity (Convertible Debt)		

Fund Target Size

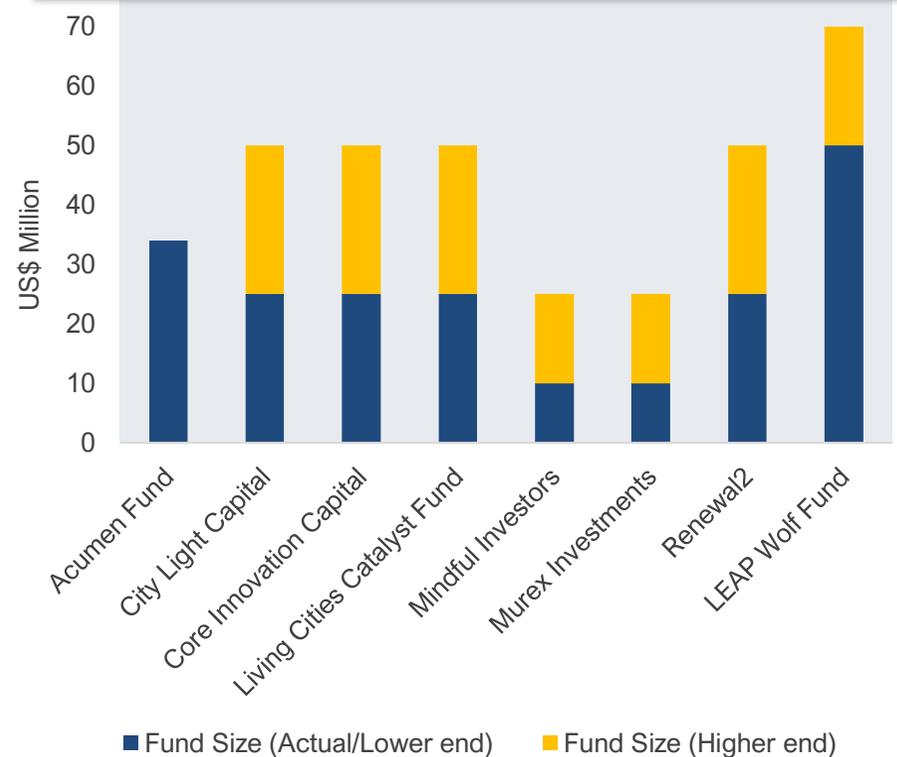
The fund should target a size of

US\$ 50 – 70 million

US\$ 50 ~ 70 million fund size looks appropriate as per available deals



Various Social Impact funds focused on a single geography as benchmark



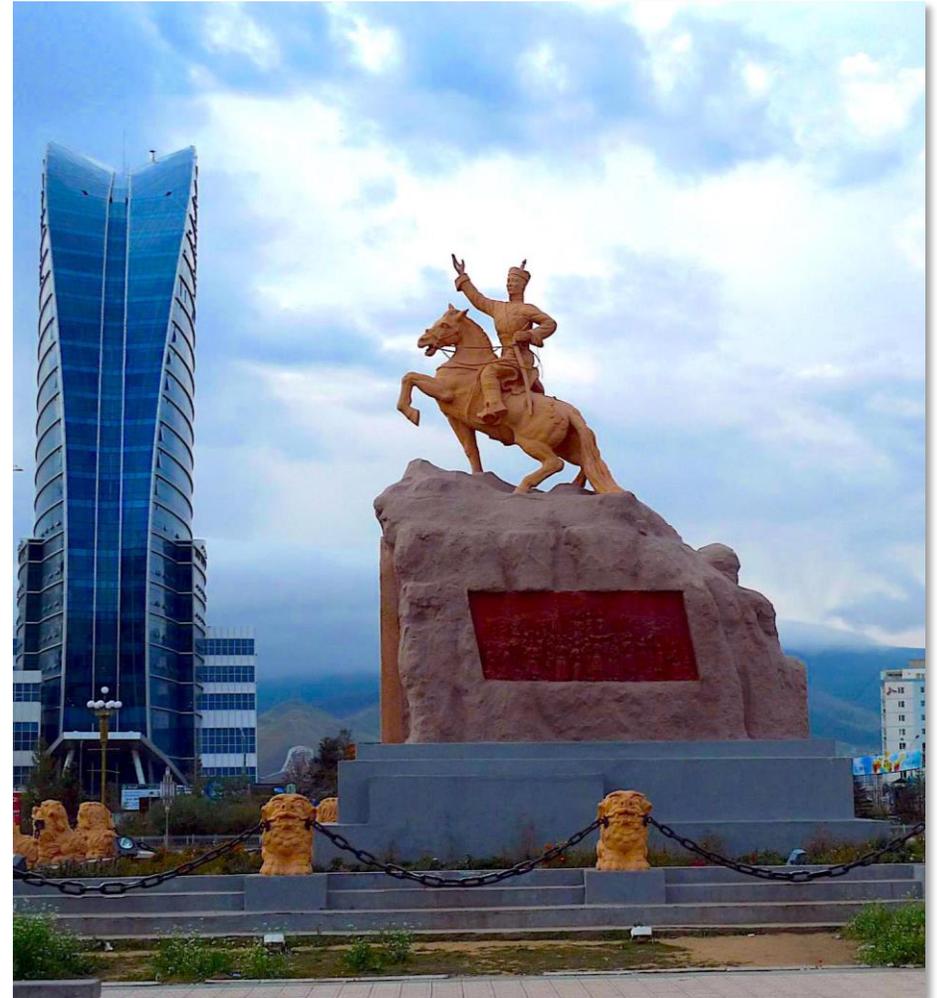
Source: [http://www.impactassets.org/files/IA%2050\(3\).pdf](http://www.impactassets.org/files/IA%2050(3).pdf)



MARKETING STRATEGY

A Unique Mongolian Proposal

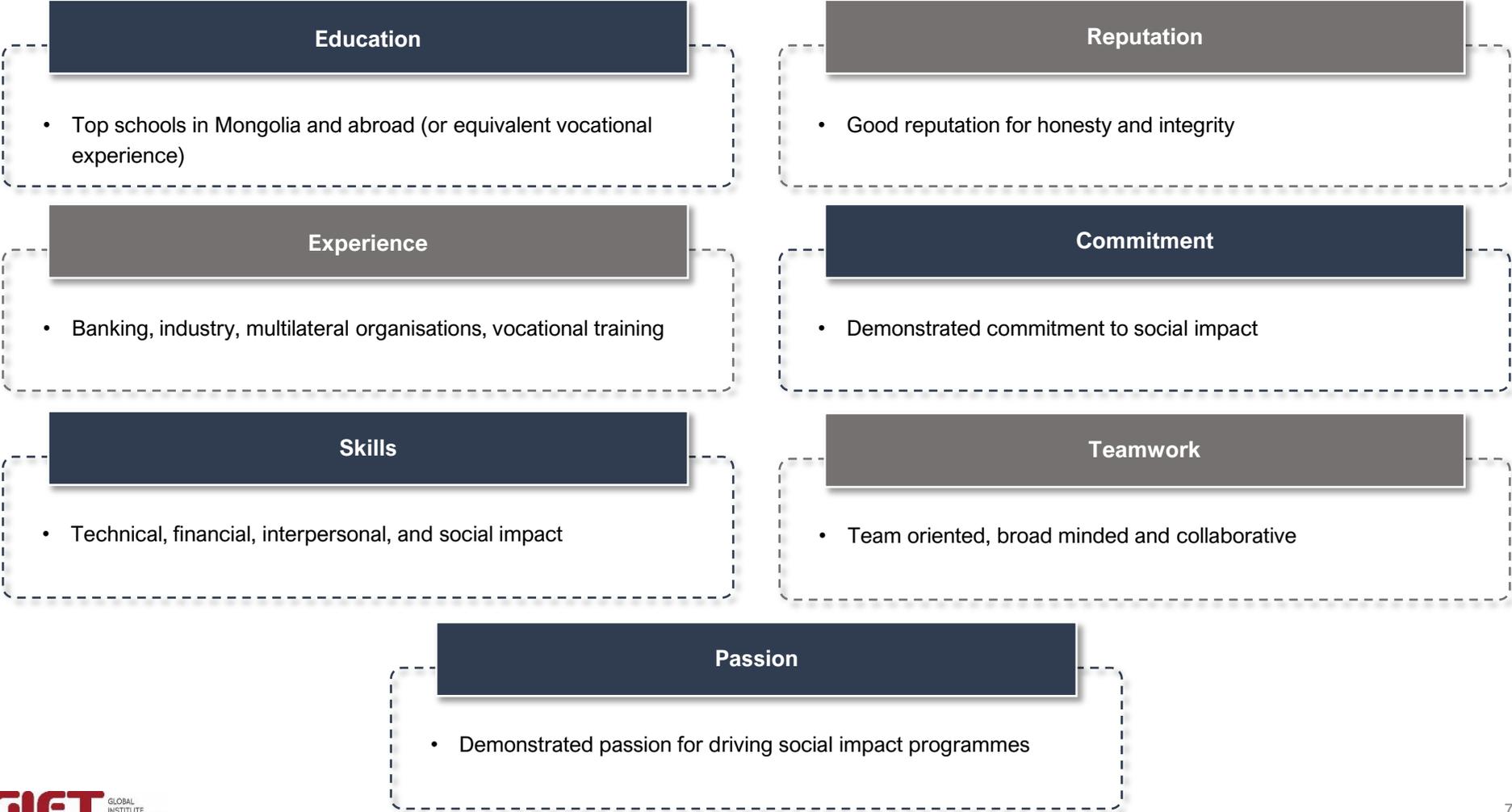
- ***New type of investment fund*** which benefits not only the investors but also the Mongolian society and environment
- Tapping into ***a unique market opportunity***
 - Focus on local SMEs to fill in the “Missing Middle” financing gap
 - Targeting non-mining SME sectors to address the “Resource Curse” and foster an entrepreneurial spirit
 - Creating a new asset class for investors to create social impact
- Emphasis on incorporating best international practices, as well as proposing new ones, with regard to ***social investment assessment and measurement***
- Strong management team with a ***‘new DNA’***
- Proposing ***an ‘improved’ Private Equity model*** tailored to impact investments



“Big Sky Thinking: Mongolia’s First True Social Impact Investment Fund”

Management Team

Defining a new type of DNA



Marketing Documentation

Full pack of necessary documents as deliverables

Pitch Book	<ul style="list-style-type: none">• Clear mission statement and ethos• Tailored to the audience• Attractive to investors• Analysis of investment considerations
Frequently Asked Questions (FAQ)	<ul style="list-style-type: none">• Constantly updated• Comprehensive and addresses all aspects of The Fund for consistent messaging
Due Diligence Pack	<ul style="list-style-type: none">• Contains all critical information regarding material aspects such as financial, legal, management, etc.• Outline approach to due diligence
Private Placement Memorandum (PPM)	<ul style="list-style-type: none">• Terms of interests of shares offered to investors• Details of the General Partners or members of the Board of Directors• Information about the investment advisor and the management agreement• Material risk factors, etc.

Create credibility through professionalism

Prioritised Targeting of Key Investors

Focused & Systematic Approach to Fundraising

	Anchor Investors			Other Investors
Who?	Mining Companies	Mongolian Corporates / High Net Worth	Multilateral Organisations & Impact Investors	Global China / Russia "3 rd Neighbour" Investors
Why?	<ul style="list-style-type: none"> Positive image Developing Mongolia Grow/support supply chain 	<ul style="list-style-type: none"> Invest in future Give back Grow/support supply chain Positive image 	<ul style="list-style-type: none"> Develop mandate Aligned objectives and interests Support Mongolia 	<ul style="list-style-type: none"> Diversification Support growing trend Emerging market exposure Positive image
Examples	<ul style="list-style-type: none"> Oyu Tolgoi Tavan Tolgoi Prophecy 	<ul style="list-style-type: none"> Newcom Bodi Group Shunklai Genco 	<ul style="list-style-type: none"> EBRD IFC ADB European Multilaterals Rockefeller Foundation 	<ul style="list-style-type: none"> Financial Institutions Endowments / Foundation Corporates Pensions Fund of funds

Key motivator for anchor investors is more social impact than pure financial return

Fund Positioning

Current players in the Mongolian fund space and their positioning

Current Market Players

Some sample of current funds in the market with a Mongolian theme includes:

- **Firebird Mongolia** – focuses on both listed and traditional PE
- **Silk Road** – focuses on listed Mongolian stocks, PE and real estate
- **Mongolian Opportunities Fund** – PE focusing on mining services, infrastructure companies and other high growth industries

Others include Origo Altai, Korea Mongolia Resources Fund, etc.

A positioning based solely on a “Mongolia Angle” may not be enough to differentiate

The impact investing fund space

Impact Investing Funds

Impact / social investment funds in the market tend to have positioning focus based on geographic region, sector, specific social mission or a combination.

Examples:

- **Renewal2** – green solutions PE fund focused in US/Canada
- **Core Innovation Capital** – financial services for under-banked in US
- **Acumen Fund** – social mission focused, less financial focus
- **Mindful Investors** – traditional PE fund that focuses on health/sustainability themes consumer products companies

Need a clear focus and social mission that is distinct to appeal to target anchors

Fund Positioning - Recommendation

Positioning should appeal to anchor investor's key motivation in addition to differentiating from current market players

It is recommended that the fund have both a geographic and social impact focus, but not necessarily a sector focus

Therefore, the fund should position itself as Mongolia's first impact investment fund whose mission is to *seek balanced economic growth that benefits all Mongolians*

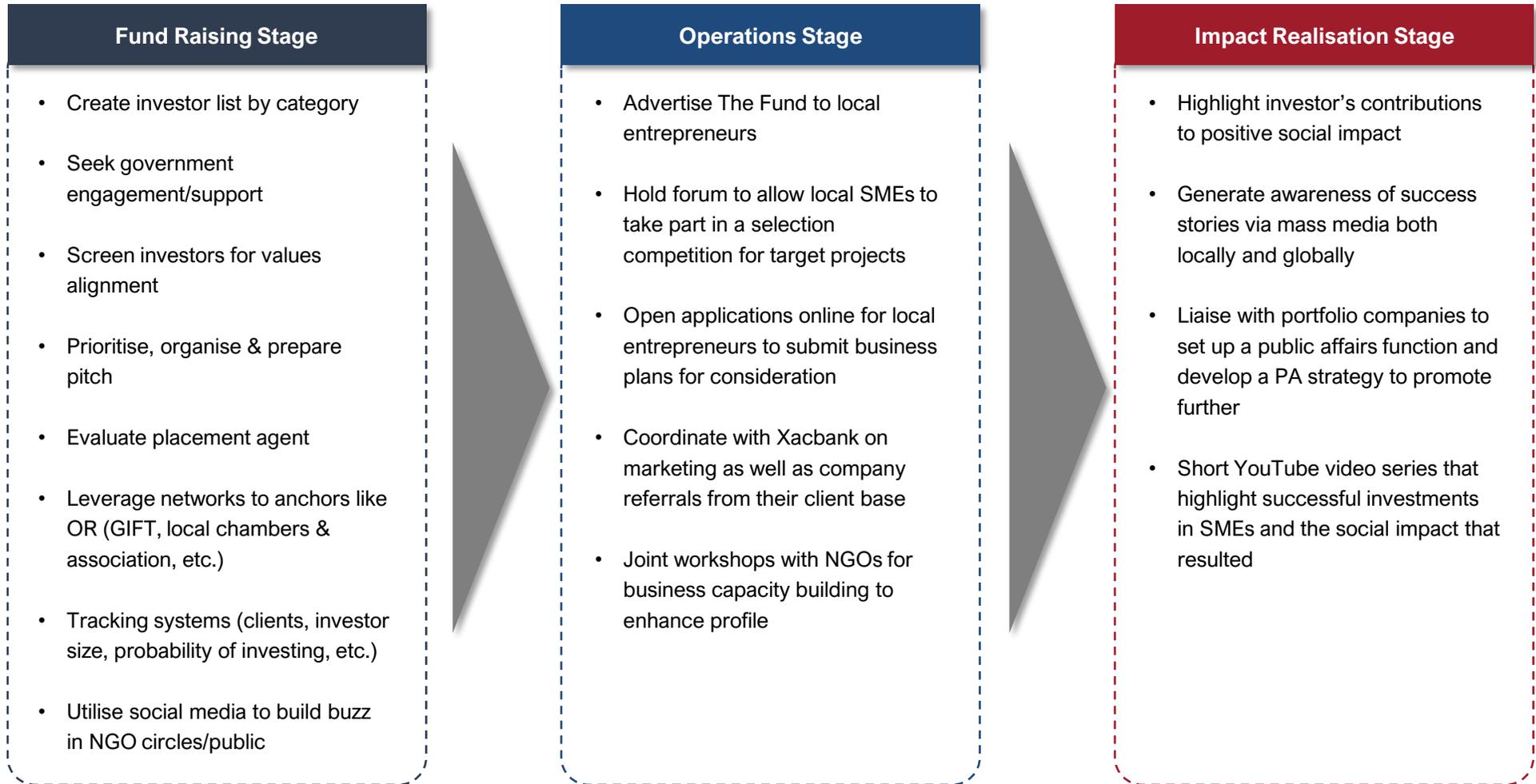
Social impact angle should be front and center in positioning in order to prevent grouping as "just another Mongolian PE fund"

Mongolia at a cross-roads in development, should stress the urgency of an impact investment fund at this moment in time

Balanced financial and social returns is possible and desirable

A balanced positioning with a social mission in addition to financial returns is a must

Ongoing Marketing Plan



Distribution and Fundraising Period

Both direct placement and agencies should be considered

Local anchor investors can be approached directly using relationships and networks

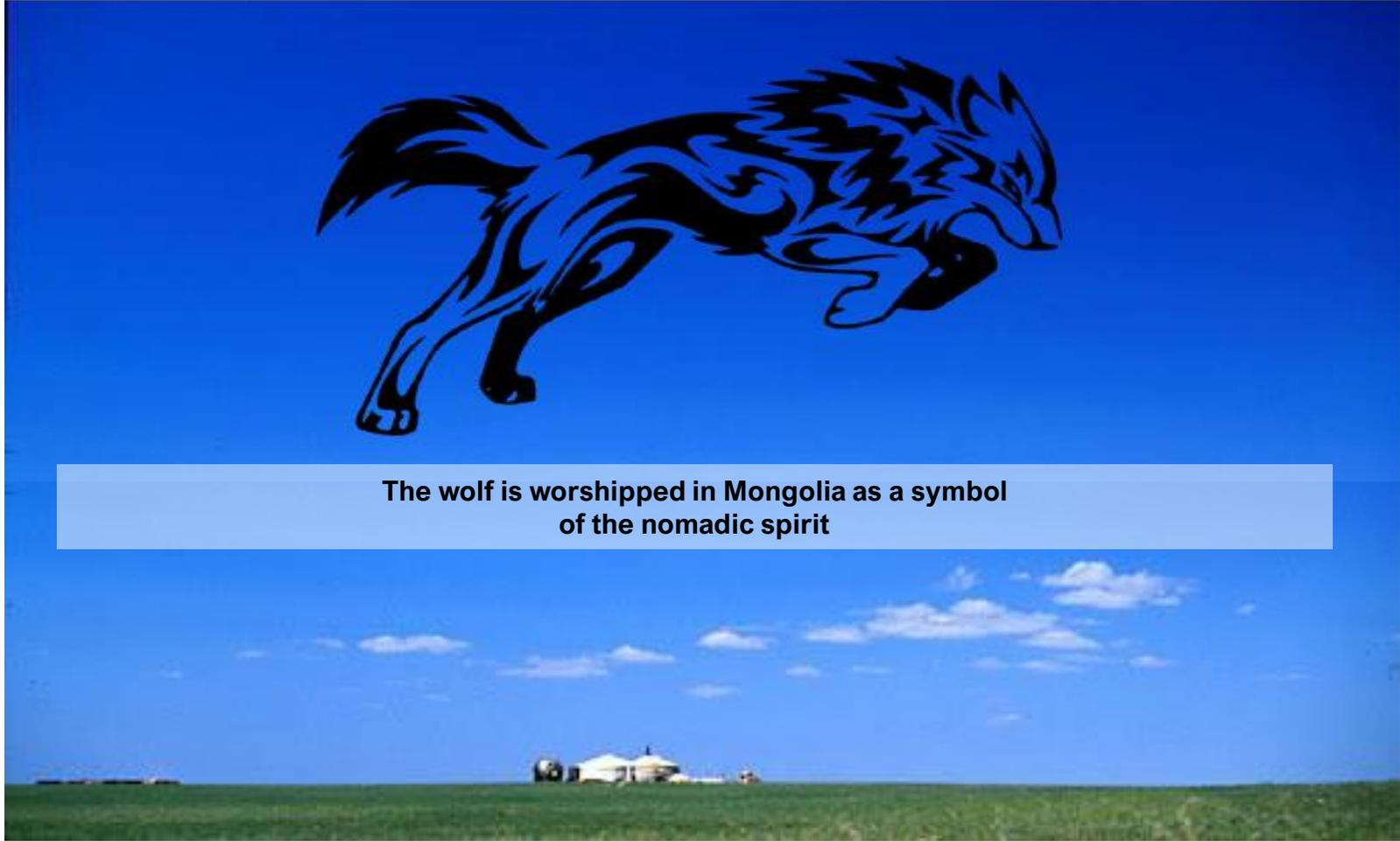
For other potential investors (such as pension funds, fund of funds, foundations and family offices) with no presence in Mongolia, placement agents with access can be considered

Placement agent generally charge ~1% commission on amount raised, however as this is impact investment, fund discounts may be secured

Funds that closed in Q3 of 2011, took an average of 17 months to fundraise vs. 20.4 months in 2010 and 11.4 month in 2007*

A social impact fund positioning may reduce this time by appealing to more classes of investors that have more than pure financial focus

Sky Wolf Fund



**The wolf is worshipped in Mongolia as a symbol
of the nomadic spirit**



CONCLUSION & RECOMMENDATIONS

Conclusions and Recommendations

Mongolia is at a critical crossroad for sustainable growth

Massive potential for SME growth

- Diversification from the mining sector
- Irreversible environmental harm must be avoided
- Crucial to have local ownership and local community involvement
- Highly educated and under-utilised workforce
- Government engagement is critical

A quantum leap in the social impact investing space

Sound basis for a new impact fund structure proposal

- Creation of a new asset class for investors to create sound impact
- Need for a fully encompassing and progressive set of social impact measurements and assessment criteria
- Attract a new breed of players in business, government and civil society
- Fund size target is US\$ 50 – 70 million with a hard cap of US\$ 100 million
- Focus sectors: Agriculture, Education, Affordable Housing, Healthcare, Waste Management, and Mining Supply Chain



APPENDIX

Definition of SMEs

“A citizen or legal entity in Mongolia engaged in small and medium business operations that generates revenue of MNT 500 million to 5 billion and employs up to 200 people. At minimum, it must be able to provide a crude financial statement and governance structure.”

Impact Fund Purpose

Mongolian Government Definition:

“Small and medium enterprises are those having less than 199 full-time and contracted personnel and up to MNT 1.5 billion in sales.”

SME Law of Mongolia

Source: Government of Mongolia, 2007, *SME Law of Mongolia*, Ulaanbaatar, Mongolia





THANK YOU!