

## A Note on Social and Impact Investing

In the past ten years various forms of Social and Impact investment have grown rapidly and new forms have been introduced. This growth reflects a range of developments on both the demand side (a new generation of social entrepreneurs and new opportunities for them) and the supply side (new investor preferences, emerging forms of investment, new modes of public action), supported in some contexts by tax incentives or other government policies.

This white paper defines and analyzes the market-space from an investor's perspective and recommends issues and opportunities in this space. The target audiences for this work are investors, entrepreneurs or students seeking to gain a basic understanding of the dynamics surrounding Social and Impact Investment. Our team has developed insights based on interviews with thirteen investment entities, ranging from foundations to pure social venture capital firms (please see Addendum A for profiles of each firm).

### Some Definitions

#### Impact Investment:

Social Impact investing is an investment strategy whereby an investor proactively seeks to place capital in businesses that can generate financial returns as well as an intentional social and/or environmental goal.

Traditional investments focus around two axes: potential profit and risk. For most private equity firms and venture capitalists, the investments are a balance between the two, how to minimize risk and how to maximize profits.



By contrast, **Social investment**<sup>1</sup> focuses primarily on broad social change and/or benefits to the local communities and the population in general.

The funds for social investment are created and supported not only by the new generation of philanthropists and foundations interested in bringing about social change but also (in some cases) by governments and other public institutions. In the past, Social and Impact investment firms have been mainly concerned with social impact (most were focused on non-profit organizations or foundations) and did not expect financial returns on their investments. Most of

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their investments are in the form of grants or other similar forms. This is changing today, as more traditional investors (family offices, private equity firms and endowment) are exploring the Impact market, seeking measurable financial *and* social benefit returns, and as U.S. laws are in a state of change regarding entity forms such as LC3 and “B” corporations as investment vehicles<sup>1</sup>.

According to the Skoll Foundation, and other sources, “impact” may be demonstrated by behavior, infrastructure and/or policy change in social and/or environmental issues. Many social investment firms seek ventures whose innovations are positioned to directly affect one or more of these issues on a large scale and can show evidence of significant impact already achieved. Broadly, behavior change includes changes in the awareness and behavior of key factors, including the general public, companies, funders, beneficiaries, etc.

Firms that belong to this category are: Skoll Foundation, Ashoka Foundation, Deshpande Foundation, Acumen, and Endeavor Global.



For some firms, a third/new axis, aside from profit and risk, is “social impact”. Social and Impact investment firms support ventures that create social impact and also generate financial returns. These investors choose to finance social enterprises - generally, organizations that are socially owned and that pursue a combination of social and economic objectives through market-based operations. Cooperatives - in housing, retail, agriculture and financial services - are a historically familiar form of social enterprise, and they remain

a major presence in several sectors of the economy. Firms that belong to this category are: Minlam Asset Management, Root Capital, World Vision (Vision Fund) and Inventure.

### **Social Entrepreneur<sup>2</sup>:**

In this paper we define social entrepreneurs as individuals with innovative solutions to society’s most pressing social problems who are driving systemic, sustainable social transformation. Rather than leaving societal needs to the government or business sectors, social entrepreneurs find what is not working and solve the problem by changing the system, providing solutions, and persuading entire societies to take new leaps. Some social impact firms like the Skoll Foundation define social entrepreneurs as society’s change agents: creators of innovations that disrupt the status quo and transform our world for the better.

## **Areas of Impact Investing**

<sup>1</sup> LC3: An LLC is a Limited Liability Company for any profit motivated enterprise. An LC3 is a relatively new "cousin" of the LLC created to give comfort to philanthropic & foundation investors that their investment would meet IRS standards and not jeopardize their tax status.

B Corporation: A certified B Corporation is a new type of corporation which uses the power of business to solve social and environmental problems.

Impact Investing spans across many sectors and regions. Each sector/region has its own unique set of factors governing social response and its own form of metrics for measuring impact. Investors entering the “impact investing” market may be looking for geographic representation or impact within a given social issue. This section analyzes three possible metrics involved in impact investing - sectors, regions and financial preferences.

## Sectors

### 1. Food & Agriculture

Food & agriculture has been the heart of our civilization. The lack of food or inequality between regions of the world creates a continuous need for impact investing. Rise in food prices and resulting hunger issues have been the core problems, largely in developing countries. Investments in agricultural solutions that alleviate this problem will have the most direct and tangible impact by addressing one of the most basic human needs. The graph below shows food prices over the last 20 years



### 2. Human Rights

Human rights issues have become increasingly prominent as the world becomes more globalized. Issues such as women’s rights, racism, democracy, children’s rights, rights of indigenous people etc fall under this category. Investments that result in empowering any of these groups of people directly or indirectly help alleviate this problem.

### 3. Health

Despite the advancements in healthcare, the statistics related to some of the problems in healthcare reflect the acute need – one billion people lack access to healthcare, over 8 million children under age 5 die of preventable diseases each year, tuberculosis kills 1.3 million people each year. Health issues like these kill more people each year than in conflict zones. Investments that result in creating affordable and profitable healthcare solutions to these segments of the world populations will result in effective impacts.

### 4. Education

Education is an important resource without which millions of people continue to remain in a stage of exploitation. With the right processes in place this void can be filled and it will result in alleviating many of the other social needs that are endemic in the same region. An area within education that has a big need is K-12 education (primary through high school education). This area faces numerous problems including funding, teacher quality, teacher shortages, overcrowded schools, unequal access to educational technology etc.

## 5. Financial Services

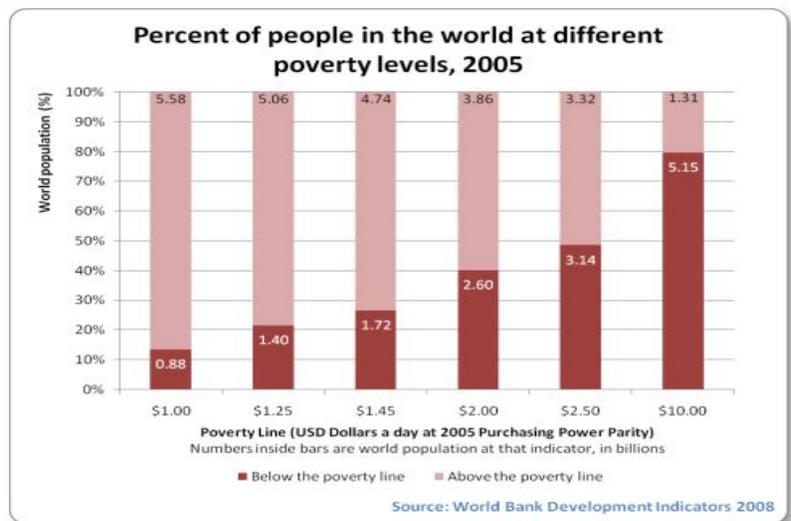
Solutions addressing the needs in various parts of the world become sustainable only with the financial needs being addressed. While external investments at a large scale are important to create an impetus, more granular financial services provided at an individual level are important to sustain positive impacts within the local economy.

## 6. Environmental

Environmental issues include issues related to biodiversity, sustainability and global warming. Both of these are large scale phenomena affecting the planet as a whole. The effects from biodiversity and global warming also transcend into other issues like food & agriculture and health. Investments in clean/green technology ideas and environmentally sustainable practices help alleviate this issue.

## 7. Poverty

With 3 Billion people in the world living at less than US \$2.50 per day, poverty has become a key issue that prevents upward mobility in living conditions even when many of the other key issues are addressed. Economic inequality also goes hand in hand with poverty. In cases where poverty for a region as a whole is addressed but economic inequality is not addressed, the fundamental problems continue to exist. Hence, both of these issues have to be tackled simultaneously. The graph below from World Bank shows poverty levels at various income levels.



## Financial Components

Impact investors may be targeting a specific region of the world – Latin America, North America, Africa, Eastern Europe, or the Far East. Each region brings its own unique set of

challenges and political/economic issues. Some of the main factors considered by impact investors include:

### Political Stability

Political stability is important for any business or investment since overall uncertainty can have a big negative impact on possible financial returns and thus deter investors. Stable political environment leads to stable business laws and a transparent investment environment. All of these encourage more entrepreneurial and investment activities.

### Evolving marketplace

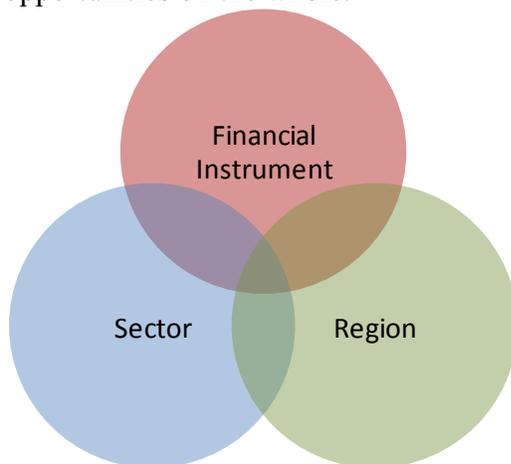
Evolution of marketplace is a key inflection point in the evolution of impact investing as a whole. Impact investment in a specific market will change from uncoordinated activities to coordinated activities with larger volumes with changes in marketplace. This will result in lower overall transaction costs.

### Economic stability

Economic stability is closely correlated with political stability. It also has its own attributes like fiscal policies, monetary policies, stable inflation etc. Economic stability leads to a secure investment environment by reducing unnecessary overall risks. This in turn will encourage more investment firms to enter the market.

### Exit Opportunities

Exit and liquidity opportunities are important for an investment ecosystem. Social and Impact investing has a relatively tighter bottleneck in exit opportunities than traditional investing. This difference becomes even more pronounced in markets that suffer from lack of exit and liquidity opportunities on the whole.



## **Investing by a firm**

Social and Impact investing by a specific firm incorporates three factors; the third factor being region, in addition to the social and financial components mentioned above. The area a specific firm invests is at a confluence of all these three factors depending on the preferences of the firm. While Social and Impact investment usually delivers both financial and social returns, the areas of investment choices may depend on the prioritization of financial and social floors for the

investments in a region of choice. Investment opportunities largely exist at the intersection of both the above factors. In some instances, a firm may compromise one of the factors and focus on the other 2. For instance, a non-profit foundation may choose to ignore many financial metrics and focus on social needs and a region of choice. Thus the ideal investment opportunity for a specific firm will depend on its own risk-reward profile. Having analyzed the three factors involved in impact investing, the following sections look into the overall market landscape, the sources of capital, types of investments and the risks associated with these investments.

## **Market Landscape**

This section describes the landscape of impact investing. It starts with discussing the target population of social impact, how the impact travels through the “impact investment chain,” and finally sizes markets for a few focus areas.

### **The Impact Target**

Impact investing seeks to improve the lives of the largest, but poorest, socio-economic group, frequently referred to as base of the pyramid, or bottom of the pyramid, or just BoP. The phrase “bottom of the pyramid” was first used by US President Roosevelt in 1932, and has subsequently been referred to by (late) Prof C. K. Prahalad (University of Michigan, 1998) and Prof S. L. Hart (Cornell University, 2005). Prof Prahalad defined this group as the 2.5 billion people who live on less than \$2.50 per day.

Since then, the World Resources Institute has defined the BoP as people earning less than \$3000 per annum, based on purchasing power parity changes in the last decade, which works out to be about \$10 per day. This unique socio-economic group, found in developing countries, is henceforth referred to as the “low-income group” in this paper.

In addition to this low-income group, there also exist people in developed countries with higher income but who still lack access to basic needs, such as housing, and who may benefit from impact investing. Typically called “BoP+,” this socio-economic group is not a focus for this paper.

The low-income group is typically under-served by existing businesses. Indeed, this was the premise behind Prof C. K. Prahalad’s book, “The Fortune at the Bottom of the Pyramid: Eradicating Poverty Through Profits” (2004). Social impact is driven primarily by engaging the low-income group to become customers and suppliers of products and services.

## The Opportunity

Serving the low-income group represents a huge business opportunity for two major reasons.

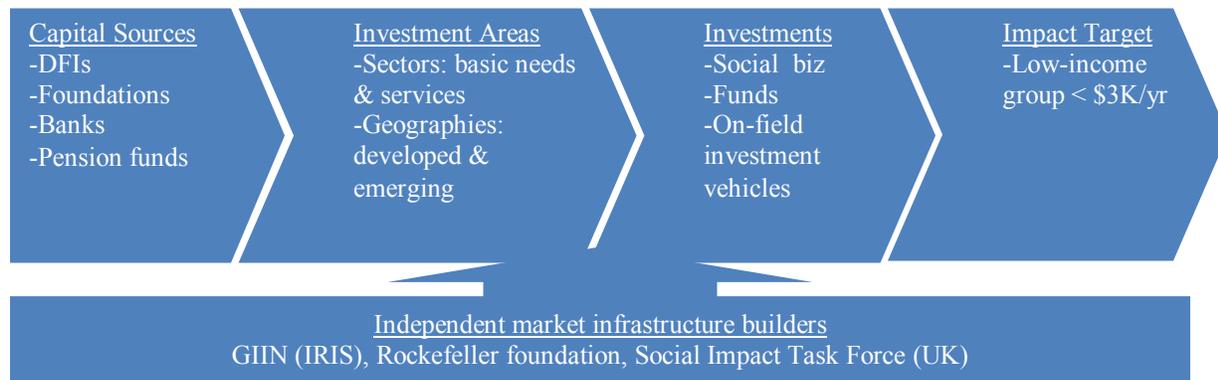
First, this socio-economic group is typically underserved by traditional businesses. It is assumed that the low-income group does not have sufficient purchasing power. Moreover, serving the low-income group requires overcoming severe operational challenges such as lack of infrastructure, lack of skilled workers, and also demands innovation in logistics, distribution and packaging. For example, someone in the low-income group may not be able to afford a 3-pack of 1-kilogram soap due to cash flow constraints, but may well be able to afford single packs of soap that are 250 grams each. Similarly, transportation costs may result in higher prices of goods compared to urban areas – an effect completely opposite from ideal – triggering new ways to collaborate and distribute products.

Second, government help can only go so far – it is difficult to sustain a solution on grants alone. A profitable, scalable business is the best bet for increasing reach and allowing low-income communities to self-sustain. Indeed, government help has sometimes resulted in a “low-income penalty,” where the lack of incentives to deliver products and services in innovative ways leads to inefficiency. As an example, Prof C. K. Prahalad found that residents in a slum area in Mumbai have to pay much more, up to 2x, for government-delivered diarrhea medication, than residents in urban Mumbai.

Businesses that target the low-income group are uniquely positioned to exploit this opportunity – they have extremely efficient cost structures and a new delivery model optimized to transfer goods and services from urban to rural, or sometimes rural to rural, communities.

## The Impact Investment Chain

The Impact Chain can be thought of as a value chain, where the value (social impact) flows from capital sources (investors) to the target (rural population) through investment areas (theses) and the actual investments (entrepreneurs, funds). Independent market builders such as the Global Impact Investing Network (GIIN) provide infrastructure such as industry standards (IRIS) and conferences (Social Impact Exchange). Each stakeholder element of the impact chain is covered in more detail in subsequent sections.



## Focus Areas

This section discusses the following five specific impact areas in more detail. Data for this section has been sourced from the Impact Investments paper by J. P. Morgan Global Research, 29 Nov 2010 [7].

- Affordable urban housing
- Clean water for rural communities
- Maternal healthcare
- Primary education
- Microfinance services

The J. P. Morgan paper also makes the following assumptions worth noting:

- Regional differences in scaling businesses, due to regulations/tax laws, can be ignored
- Investors are assumed to have access to financing these businesses, and interest payments on such financing does not materially impact profitability
- Investments are assumed to be for the next ten years
- Impact businesses are assumed, like traditional businesses, to have a direct correlation between invested capital and revenues

The following table summarizes key metrics for the focus areas. All metrics are over a 10 year investment period. The available market and penetration rate figures differ according to the specific focus area. For instance, the market for maternal health is the number of households with unattended child birth, which is significantly lesser than total number of households where children are born.

Focus areas	Affordable housing	Water	Primary education	Maternal health	Microfinance services
Required investment	\$214-\$786B	\$5.4-\$13B	\$4.8-\$10B	\$0.4-\$2B	\$176B
Profit opportunity	\$177-\$648B	\$2.9-\$7B	\$2.6-\$11B	\$0.1-\$1B	\$35B
<b>ROI</b>	<b>80%</b>	<b>50%</b>	<b>50% -100%</b>	<b>25% -50%</b>	<b>20%</b>
Available market, #households, M	393	683	238	113	500
Penetration rate	50%	40%	40%	40%	50%
Target market, #households, M	196	273	95	45	250
<b>Operating margin</b>	15%	10%	10%-20%	5%-10%	10-15%
<b>Risks</b>	Delivery in rural communities, conflict with govt. programs	Delivery in rural communities, conflict with govt. programs	Lack of skilled teachers, cultural issues (eg resistance to educate girls)	High cost of some services (eg Caesarian deliveries), lack of trainable workers, lack of basic infrastructure for hospitals	Crowding (\$40B invested already), lack of credit risk analysis frameworks, govt. regulation

## Other Areas

Besides the focus areas mentioned above, there are several opportunities that do not have clear ROI estimates. However, they are significant enough to warrant a closer look.

	Agriculture	Energy	Technology	Infrastructure
Opportunities	Supply chain Logistics Distribution Aggregation	Solar, biomass sources for light, heat and electricity \$2.1B/yr market in India alone	Proven technology as medium for diverse services (eg mobile for payments)	10% GDP investment in roads, airports, power generation & transmission, water treatment
Risks	Localized, fragmented	Regulatory	Security, business models in developed world may not transfer	Government bound, bureaucracy, possible corrupt practices

## Capital Sources

The organizations which provide impact investment capital range from public to private and from profit-seeking to non-profit. Earlier in the development of impact investing, capital generally came from high net worth individuals and private foundations. As the movement has become more established, the amount of capital available has increased as new attention has come from institutional investments, which work on a much bigger scale. These larger investors are not necessarily motivated solely by the desire to achieve social and environmental goals. Many investment committees feel that their fiduciary duty is to achieve the best possible financial return first and foremost. However, they see impact investing as an important emerging asset class and a way to generate alpha, either by identifying new opportunities or by mitigating risks. The table below lists the major categories of capital sources, their typical investment vehicles and some example organizations operating in each category.

Type of Organization	Philanthropic Foundations	Development Finance Institutions (DFIs)	High Net Worth Individuals/Private Wealth Managers	Community Development Finance Institutions (CDFIs)	Commercial Banks	Pension and Retirement Fund Managers
Typical Investment Vehicle	Grants, PRIs	Loans, guarantees	Angel investments in the form of equity	Tax-advantaged Loans	Loans	Loans, equity

<b>Example Firms</b>	Omidyar Network	International Finance Corporation, European Bank for Reconstruction, US Overseas Private Investment Corporation	Capricorn Investment Group, New Island Capital	JP Morgan, Prudential	TIAA-Cref
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## Investment Types & Performance

### Investment Types

Traditional investments have been categorized by the components of its assets like equities, fixed-income (bonds), cash equivalents, debt, venture capital, commodities, private equity etc. They could be further divided into various sub-components at more granular levels. Impact investments, unlike traditional investments do not just deal with financial returns, but also deal with social returns. At the same time, impact investments differ from socially responsible investments by corporate CSR (Corporate Social Responsibility) initiatives. Hence, impact investments must be differentiated and defined in a manner that better represents them. The JP Morgan report on impact investments lists 4 key attributes for an asset class, all of which exist for impact investments (thus making them a distinct asset class)

1. Requires a unique set of investment/risk management skills
2. Demands organizational structures to accommodate this skill set
3. Serviced by industry organizations, associations and education
4. Encourages the development & adoption of standardized metrics, benchmarks, and/or ratings

The table below shows some of the impact investment funds in various typical categories

Asset Classes								
Cash	Senior Debt	Mezzanine/Quasi Equity	Public Equity	Alternative Instruments				
				Venture Capital	Private Equity	Real Estate	Other REAL Assets	Hedge Funds
Charity Bank	Root Capital	Inventure Fund		Agora Venture Fund, Investors' Circle	Acumen Fund	TIAA-CREF Corporate Social Real Estate Fund	EcoLogic Development Fund	

Format Source: parthenon.com

Considering the overall maturity of the market, the impact investment venture funds largely involve private debt (including micro-finance debt) or equity investments. As this investment area matures further, these funds will diversify further to include publicly traded investment components. Many impact investments tend to be in regions where the entrepreneurs are not as financially astute. They also cover economic regions with a higher risk profile. As a result, many of the investments tend to have a straight forward mix of debt and equity. In regions where an impact investment fund touches on Bottom of the Pyramid entrepreneurs (as in the case of Inventure Fund), the early stages of funding may actually have more debt components considering the financial knowledge of the entrepreneurs.

**Gaps in Investment Types**

A big gap in the impact investment funds is the ability to track and measure the social metrics. The industry is still consolidating around this realm resulting in various standards like IRIS and GIIRS. Impact investment funds need a social metric that can seamlessly integrate into the financial components and can enable the funds to dynamically adjust both its financial and social metrics as the investment evolves through various life cycle stages. This is still a gap since the investment arena has evolved around what is largely a single variable (financial return) and needs to factor in a second variable (social return) into existing complexities.

The table below shows some of the typical firms at various stages of investments in a new firm. One significant gap in this is the lack of density among seed stage investment firms in the emerging economies.

Stage	Typical Firms
Seed	Investors’ Circle, Echoing Green
Series A/B	Acumen, Omidyar Network, Investors’ Circle
Mezzanine/Debt	Inventure, Minlam, Deshpande Foundation

**Initiatives to address gaps**

Social Impact Bonds



One of the pioneering activities to address the gap in metrics is the concept of *Social Impact Bond* that was introduced in the United Kingdom in 2010. These are similar to equity investments and repayment is contingent upon achieving a set social return. This has been recently adopted in the US and has been named *Pay for Success Bonds*. The US government has earmarked

\$100 Million for social impact bonds in the proposed 2012 budget. The adoption and standardization of such a metric in asset classes helps venture capital firms to combine or leverage this in either a direct or indirect manner in order to track social returns. The image below shows the typical operation of the social impact bond.

### Mentor Network

This initiative will address the lack of density of early stage impact investing firms. A primary reason for this is the higher level of execution risk that ideas catering to impact investments are perceived to have since this is a nascent field. A well established mentor network by an investment firm can guide the entrepreneurs with appropriate and timely guidance thus reducing the overall execution risk. Once this idea becomes a proven model, more impact investing firms will be willing to invest in the early stages.

### Universal Measurement Standards

This is an obvious initiative hitting the problem at its core. The industry has different standards and custom measurement techniques and tools used by prominent firms. This is because even though there are firm independent metrics, these cannot be easily customized or trimmed according to a specific individual investment strategy. As a result, some of the firms that invest with a very specific approach tend to develop their customized metric system that is more efficient for their approach. One way to avoid this problem is to develop a comprehensive metric system that can also be easily customized for each firm's investment strategy (while retaining the common measurement methodologies).

### **Investment performance**

Return on investment for impact investing differs according to the investment vehicles one looks at. For each type of vehicle, returns can be compared to those of a similar style of traditional investment. Looking at the table, one can see that in some cases the expected return on impact investments are comparable to adjacent traditional investments, as in the case of debt and equity issued in emerging markets. In others, investment managers are assuming a lower return for impact-related investments. There was a wide diversity of expectations even within each category. While there is not as much data available on realized returns, what is available in the debt category showed that realized returns met or exceeded expectations.

<b>Impact investment type</b> <i>Benchmark returns</i>	<b>Range of Expected Returns</b> <i>Average Benchmark Return</i>
<b>Developed Market Impact-Related Debt</b> <i>JP Morgan US High-Yield Bond Index</i>	<b>0-5%</b> <i>11%</i>
<b>Emerging Markets Impact-Related Debt</b> <i>JP Morgan Corporate Emerging Markets Bond Index</i>	<b>8-12%</b> <i>9%</i>
<b>Developed Markets Impact-Related Venture Capital</b> <i>Cambridge Associates US Venture Capital Index</i>	<b>15-20%</b> <i>28%</i>

<b>Emerging Markets Impact-Related Venture Capital</b> <i>Cambridge Assoc. Emerging Mkts Venture Capital and Private Equity Index</i>	<b>12-15%</b> <i>10%</i>
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## Profiles of Investment Vehicles

We interviewed 13 investment firms; some firms were Social Investment type and others were Social and Impact Investments firms. Addendum B shows the questions that were used for the interview. The responses were incorporated in various sections of this paper. The details of the various firm's profiles and their success stories are in Addendum A.

<b>Firms</b>	<b>Investment Type</b>
World Vision International (Vision Fund)*	Social and Impact
Deshpande Foundation*	Social
Skoll Foundation*	Social
Ashoka Foundation*	Social
Endeavor Global*	Social
Omidyar Network*	Social and Impact
Echoing Green*	Social
Inventure Fund*	Social and Impact
Gray Ghost Ventures	Social and Impact
Minlam Asset Management	Social and Impact
Root Capital	Social and Impact
Draper Richards Foundation	Social
Acumen*	Social
Investors' Circle*	Social and Impact

\* Firms interviewed

## Challenges & Risks

### Challenges

Impact investing has already made a mark in several sectors and across many countries. However, the industry still faces challenges as it tries to gain acceptance in the minds of mainstream investors. In order to achieve the requisite scale the industry will have to focus on innovations and improvements in analytical tools, capital markets, legal system and a common field language. Challenges faced by Social Impact investment are described below.

**New domain with little proof of success:** As social ventures get to scale and actually make social impact we will have more data on how the industry functions. More success stories to attract further capital infusion into social impact investments are required. As the investment asset class matures it would be easier to leverage more capital from new investors. According to Endeavor Global the

industry faces a lack of smart capital which usually constitutes of investors astute about their investments. Having forums where impact investors convene, share knowledge, and collectively invest in research would benefit the social impact investment community. One of the platform firms turn to for market data is the *Global Impact Investment Network (GIIN)* Investor's Council, sponsored and funded by the Rockefeller Foundation.

**Investor expectations:** Given the lack of structure and definition associated with any nascent industry, including Social and Impact Investment, it is expected that there is not enough data yet on investment performance. Investors thus approach this market with wide variety of expectations, resulting in varying expected returns in terms of social and financial returns. Since investors rely on their own judgment and proprietary systems to assess risk this leads to disparate investments on the same deal even amongst investors with same risk profile. Also, investors' expectations in terms of investment areas are divergent. For example, World Vision faces the challenge of catering to investors with agendas much more reflective of environment and climate, and not just limited to social poverty. It is difficult to stay focused on the mission when serving broad expectations. Individual investors base their expectations off of the sector, geography, reach, scope and fit of the investment. In the absence of a standardized measurement, Social Impact venture firms include these factors when they pitch the fund to individual investors to address the broad return expectations of the audience.

**Speed of return:** A time horizon of 10 years is typical with traditional venture capital investments. However, in case of Social Impact Investment, this could get extended to 15 years. Longer time to return implies that this industry will take a much longer time to mature than other markets such as venture capital. Social entrepreneurs are already squeezed given lower rate of financial return. Moreover, they have to select an exit strategy that ensures that the social impact will continue in the new business model. Such constraints further reduce the range of possible exits increasing the time to realizing returns. Unfortunately this is a challenge that will persist with the investment space until further maturity is attained.

**Measurement:** A large number of firms use proprietary measurement systems to measure social impact. Only a small percentage of the firms interviewed use standard tools like *Global Impact Investment Rating System (GIIRS)*, while the remaining did not quantify social impact at all. Given the range of techniques used, it is not surprising that there is little consistent quantitative data about social impact achieved to date. Rigorously assessing progress toward social impact expectations will only be possible once standard social metrics are adopted. It is necessary to measure social impact to attract more capital and for setting up a marketplace. Those firms not using tools rely on broad quantifiers to assess the impact of their projects. Omidyar Network for example relies on the reach and engagement of its investments to monitor the social component of the return.

**Efficient Market:** The deals in social impact investment space are typically complex and the associated risk is not understood in all cases. Such characteristics along with a fragmented demand and supply lead to high search and transaction costs. Geographical breadth of the opportunities exacerbates the problem further. Endeavor Global, for example, covers more range of countries singly than venture capital firms. Some firms such as Omidyar Network try to work around by investing through other Social Venture funds in geographies where they don't have a team.

**Capacity:** In this nascent stage of social impact investment, number of proven business models and the companies deploying them is low. This lack of investment opportunity reduces the rates of return

that investors require. This challenge is being addressed by some innovators working across a spectrum of segments and business models. In the United States Impact Investment Banking organizations such as “*Wall Street Without Walls*” are working, in different ways, to provide investors with more efficient deal-sharing capability, more attractive investment structures, and the liquidity that many require.

**Scale:** Impact investment is characterized by small average deal size with diligence costs comparable to traditional investments. Scale is necessary to spread the fixed costs across a larger pool of investors. In an effort to support the scale, innovators have developed mechanisms to make impact investing accessible to retail investors. For example, the *Calvert Community Investment Note* can be bought in the United States for \$1000 minimum from brokers and offers up to a 3 percent coupon.

**Public sector support:** Capital infusion into the social impact investment space is needed to accelerate growth. The additional capital would also de-risk some of the existing investments. A government match is one way to achieve this. For example governments in the European Union match social impact investments. The investors still get to keep the upside but downside is capped. A similar provision from public sector/capital markets in the US is needed.

## Risks

Impact investment involves several different types of risks that are typical in traditional investments. According to the JP Morgan paper on impact investments, the nascent industry also faces increased legal and reputational risks which arise due to operating in emerging countries and with vulnerable populations.

**Legal and Regulatory:** For entrepreneurs trying to setup shop in a bureaucratic country the legal and transactions costs could be steep. Such an environment also reduces the exit options. In India, Omidyar Network depends on the country teams to manage ground operations. This underscores the need of having a local team well versed in local legal framework. Omidyar Network also has investment initiatives in “*Government Transparency*” and “*Property Rights*” in order to build a strong legal framework and enable economic growth through market based approaches.

**Reputational:** Social impact investors are posed with the dilemma of balancing social impact and financial return. In the absence of standardized impact measurement tools it is difficult to achieve this balance and even more difficult to communicate it to the society. Social impact investors might be viewed as profiting from the poor. However, research shows that the reputational risk is diminishing as people are now more educated about social impact investment. For example, poorer sections of the society prefer micro-financing over conventional high-interest market loans.

**Company:** Company risk is common across any type of investment and can be reduced by conducting proper due diligence. World Vision for example has a well-documented policy for applications that are eventually submitted to a loan committee. The committee consists of third party microfinance experts and makes a recommendation on the credit worthiness.

**Country:** Many social impact investments are made in emerging countries and are hence exposed to the risk posed by the financial and political environment of that part of the world. In the recent past

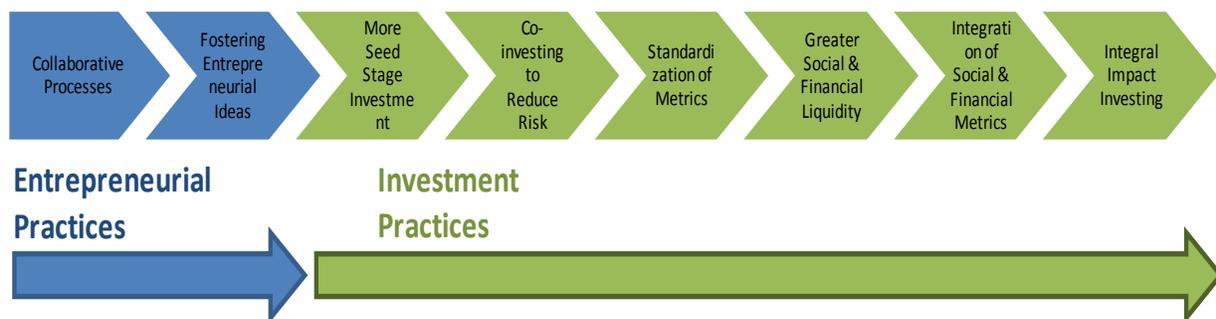
this risk has been more relevant as entire states have been in crisis. Country risk can be reduced if not eliminated at the time of due diligence through a local team that is aware of the political and financial situation in the country and sector.

**Currency:** A direct result of investing in foreign economies is currency risk. Hedging instruments might be expensive or even unavailable in cases where country's currency is not liquidly traded. This risk is easier to address in case of sectors such as micro-financing where the investment cycles are shorter and profits can be re-invested the same geography. In other sectors, social impact investors who prefer lower risk invest through a local entity with longer horizons.

**Social Impact Risk:** Social impact investors require performance data to measure impact of their investments. It follows that these investors could now use the same data to set terms on their equity or debt share in the form of targets or covenants. The measurement method of social impact then itself poses a risk. In the absence of standardized measurement tools venture capital firms today cannot address this risk.

## Areas of Innovation within Social and Impact Investing

Social and impact investments are largely connected with the entrepreneurial practices that they are invested into. Hence any new innovative approach needs to take into account both the investment and entrepreneurial practices. This is a comprehensive process where each step also builds on its predecessor as shown in the diagram below to create a completely comprehensive improvement in impact investment. The approach here is to identify the gaps in the existing process at each stage and assess how these gaps can provide pointers to innovative approaches of a new firm. This can be useful for any new investment firm looking to create its own pivot since there are currently few or no firms addressing these gaps/needs. The specific gap that a firm can look into for innovative approaches may depend on its own requirement of social and financial returns through its investments.



### Entrepreneurial Practices

#### Collaborative Process

A big risk in terms ROI in the impact investment arena is the execution risk which can be a result of various factors like education, knowledge of best practices, institutional transparency etc. One way

to mitigate this risk is to create an effective exchange of best practices and pit falls in such a manner that successful business models can be ported across regions with minimal changes, thus greatly reducing the execution risk.

### Fostering Entrepreneurial Ideas

This is a subsequent extension of the collaborative process wherein the entrepreneurs can be provided education tools, guidance and further resources. This is akin to what seed stage investment firms like Y Combinator have contributed to the traditional early stage investment arena. It will eventually result in more ideas and innovations in the impact investment space and will also help address the current void in early stage impact investments.

Currently there are no firms in the entrepreneurial practices space which has resulted in a gap in the process of creating an entrepreneurial ecosystem. Any new firm can have the possibility of high social and financial returns by focusing in this space.

## **Investment Practices**

### More Seed Stage Investments

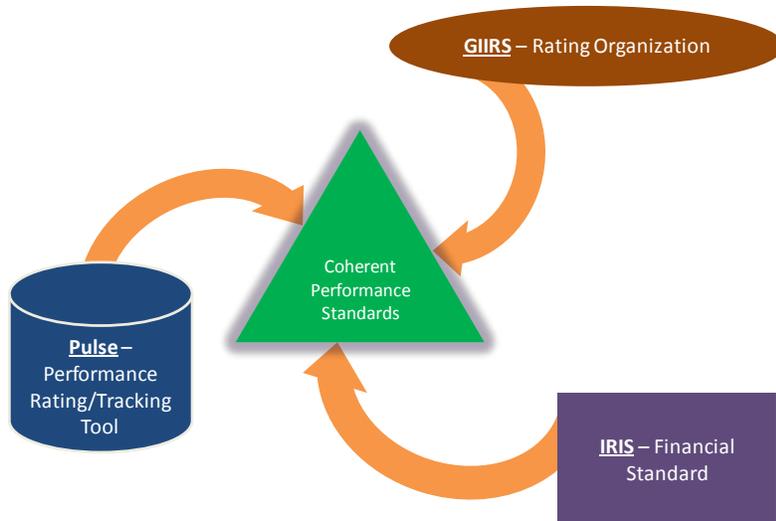
This is currently a big gap in the impact investment arena and it goes hand in hand with the entrepreneurial practices mentioned above. The earliest stages with significant collection of investment firms end up being in the mid stages (Series B or beyond) thus leaving a significant gap in the seed stages. This is a result of high execution risk in the early stages. Thus allocating more seed stage investments goes hand in hand with fostering and sustaining more entrepreneurial practices. Such an approach can also be a good unique proposition for a new entrant and can help set apart their investment practices.

### Co-investing to Reduce Risk

Social and impact investing differ from traditional venture investments both in risk and reward. Although the failures are less dramatic, the financial return from successes may not match those from traditional venture investments, and the most pressing issue causing both failures and low returns is execution in places with under developed infrastructure and/or management skill. One way that VCs can approach this unique risk-reward scenario is by aggressively seeking ways to co-invest or “syndicate” with other investors or government agencies. The best social venture firms succeed because operational risk is countered through contacts and sound advice. Syndication provides additional stakeholders to grow the network of resources and significantly tilt the balance of a social firm towards operational, and eventually, financial success.

### Standardization of Metrics

As per the findings of SOCAP (a multi-platform organization dedicated to the flow of capital towards social good), the need for a coherent performance tracking system has risen with rise in the supply and demand of impact investments. The major metrics as of the creation of this note are IRIS, GIIRS and Pulse. The general consensus in the industry is that IRIS can be viewed as a financial standard, GIIRS a rating system and Pulse a tool to track the metrics.



A comprehensive and seamless integration among the 3 will result in higher transparency, more standardization and lower overall transaction costs. The lower transaction costs will result in more investment firms (and more entrepreneurs) and thus increase the overall market share for all players. Thus standardization can be viewed as a critical factor. The only issue that impedes the standardization of metrics is the implementation costs associated with it. This can be addressed by one or more of the impact investment firms investing in the standardization of metrics that indirectly result in positive social benefits instead of the normal approach of investments that result in direct impacts. An innovative approach to address the gap in this space is possibly more applicable for an investment firm that prioritizes on social returns over financial returns.

### Greater Social & Financial Liquidity

Impact investment being a nascent field faces liquidity constraints which are especially more pronounced since they involve not just the financial component but also the social component. One way this difficulty can be addressed is actually by leveraging the complexity of impact investments as a possible advantage to derive more liquidity in the industry. This can be achieved through trading social impact for money. It builds on two of the concepts discussed above – more indirect investments by current impact investment firms and standardized metrics that create “social bonds”. The idea of such social bonds has already gained traction through the concept of *Pay for Success Bonds* that is propagated by the US government. This is important to sustain and further evolve the impact investment sector because of the sheer diversity in terms of the requirements from various impact investing firms. Such diversity among stakeholders creates many mismatched investor-investee situations thus resulting in many deals not flowing through. A single entity that provides for the trade of standardized social bonds and money can help alleviate this problem.

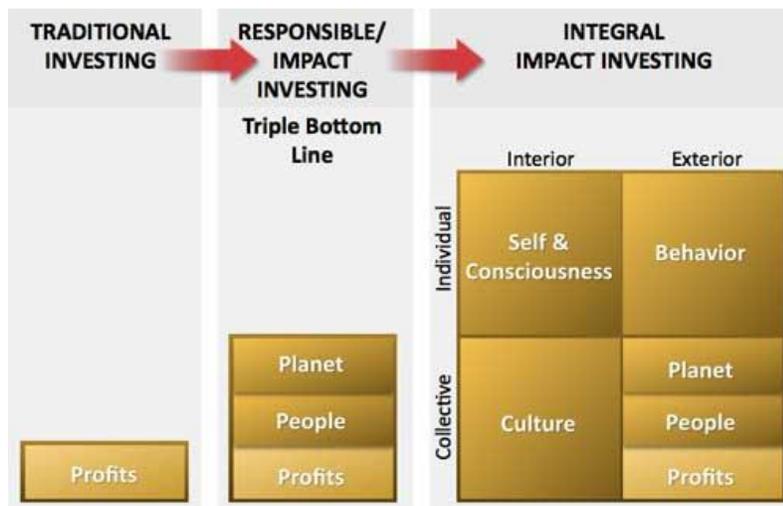
### Integration of Social & Financial Metrics

This can be seen as the next stage after standardization of metrics and attaining of greater liquidity. Impact investment being a nascent field is all but a microcosm of the traditional investment field. In order to attain long term sustainable growth, impact investment has to create involvements from asset owners across the entire investment ecosystem. Traditional investment firms are currently not incentivized to branch out into the impact investment sectors because of no effective means to measure the return on investments (ROI). By effective integration of financial and social metric into

a single financial ROI, the gap between impact investment and traditional investment ecosystems can be bridged to bring a much larger number of players into the investment side and thus create more organic growth in this sector.

### Integral Impact Investing

This is the final stage of impact investment improvement. Here the generally intangible components of behavioral and cultural aspects can be effectively incorporated into impact investment decisions once all the relatively more tangible metrics social and financial returns are standardized and integrated. At this apex stage, impact investing becomes comprehensively standardized with all facets of investments being effectively addressed, as shown in the image below.



Source: <http://www.integralimpactinvesting.org>

## Conclusion

Social and Impact investing is a very nascent field with possibilities for major changes in the future. The ideas and thought processes in impact investing will have more effects on traditional investing approaches over time not only because of the need to create positive social impacts, but also because of the increasing need to diversify investments from traditional realms for better financial returns. These needs have been more pronounced since the events like the 2008 financial meltdown.

Today, the Social Impact Investment industry is at a delicate point. While there are a lot of opportunities, success for this industry is not certain. An efficient market infrastructure to help match the money with entrepreneurs is important in the nascent phase as businesses experiment with different business models. Government subsidies, matches can help de-risk this phase for the investors as well as the entrepreneurs. A standardized method of measuring social impact is critical to gaining acceptance amongst the institutional investors. If the different entities in the eco-system, including governments, provide the necessary support, it will take couple of decades to reach a sustainable scale.

While it is possible to specify key sectors or a region which may need Social and Impact investing, this paper has taken a deliberately sector and region agnostic approach focusing instead on laying

more emphasis on the thought processes for future innovations. It is hoped that this way, the suggestions are valid for a longer timeline. Since Social and Impact investing is a very new concept, it has voids in its processes and lacks a comprehensive support making marketplace transactions more expensive overall. Hence the innovations suggested above for new Social and Impact investment firms are along the lines of filling these voids in a creative manner. This will help the investment firm become more established and also help create a better marketplace in the industry over time.

## Addendum A

### Detailed Profiles of Investment Vehicles:

#### **World Vision International (WVI) and Vision Fund**

URL: <http://www.worldvision.org/> and <http://www.visionfundinternational.org>

Location: UK, USA, Belgium, Switzerland, Kenya, Singapore, Thailand, South Africa, Costa Rica, Senegal, Cyprus

Number of employees: 40,000 (2010)

CEO/Leader: Kevin Jenkins (International President), Reverend Bob Pierce (Founder)

Type: Social and Impact Investment

World Vision is a Christian relief, development and advocacy organization dedicated to working with children, families and communities to overcome poverty and injustice. VisionFund is the microfinance subsidiary of World Vision. VFI focuses most of its micro-lending, along with support and training, in areas where World Vision has ongoing Area Development Programs. Currently in FY10, throughout the World Vision partnership, VisionFund-affiliated microfinance institutions have an overall portfolio of US\$373 million with more than 626,000 clients in 42 countries with a loan repayment rate of 98%.

#### Example of a Success story:

Loan client: Grace Atieno Amol

Age: 38 (in 2007)

Location: Gem, Kenya

Family: Four children (husband is deceased)

Work history: Grace bought and resold used clothing to earn income. Then she joined a women's self-help group, applied for a loan, and started selling new clothing. Subsequent loans have enabled her to sell water purification supplies and start a fishing business.

Type of loans: Group and individual loans

Loan use: \$133 to purchase clothing for resale (repaid in three weeks), \$400 to begin selling shoes (repaid in three months), \$800 to sell water purification chemicals (repaid in six months), \$1,600 to purchase fishing nets, hire workers, and start a fishing business

Employees: 15

Assets before loans: Small plot of land

Assets after loans: Three-bedroom home on the land

Living standards: She is comfortably paying school fees for her four children. Two are in primary school, and two are in secondary boarding schools.

Perspective on enterprise: "Though I am widowed, I believe the sky is the limit. I still remember the word of my mother—that victors are definitely failures who refused to give up. I will never give up."

**Deshpande Foundation**

URL: <http://www.deshpandefoundation.org/>

Location: Massachusetts (USA), Karnataka (India)

Number of employees: ~29

CEO/Leader: Gururaj (Desh) and Jaishree Deshpande in 1996

Type: Social Investment

Deshpande Foundation is the family's investment in promoting entrepreneurship and innovation as catalysts for change. Over the last 15 years, the Deshpande Foundation has embarked on large scale projects in the United States and India. A key role of the Deshpande Foundation is to help organizations develop two things- Innovation mindset and Infrastructure to enable innovation.

**Success Stories:**

Akshaya Patra – This is a school lunch program currently serving 1.4 million children every day. All the kitchens under the purview of Akshaya Patra are ISO certified.

Agastya – This is a science education program that will scale up to reach 7 million children annually. Agastya international foundation runs one of the largest hands on science education program in the world.

Leaders Accelerating Development (LEAD) – This program involves 13,000 college students who conduct community service in Karnataka state in India.

All of the three success stories above were endeavors that were initiated and supported by the Deshpande Foundation. They faced hurdles that every non-profit and social enterprise faces when it comes to scaling. But innovative practices by Deshpande Foundation ensured that scalability can be attained. This also proved that non-profit/social enterprises are as capable of creating successful and highly scalable solutions as conventional for-profit enterprises.

**Skoll Foundation**URL: <http://www.skollfoundation.org>

Location: Palo Alto, CA, USA

Number of employees: ~30

CEO/Leader: Jeff Skoll (Founder), Sally Osberg (President)

Type: Social Investment

Skoll created The Skoll Foundation in 1999 to pursue his vision of a sustainable world of peace and prosperity. Led by CEO Sally Osberg since 2001, Skoll's mission is to drive large-scale change by investing in, connecting and celebrating social entrepreneurs and other innovators dedicated to solving the world's most pressing problems. Skoll is now one of the leading foundations in the field of social entrepreneurship. Over the past 10 years, it has awarded more than \$250 million, including investments in 81 remarkable social entrepreneurs and 66 organizations on five continents around the world that are creating a brighter future for underserved communities.

Success Story: AFLATOUN

Skoll Entrepreneur(s): Jeroo Billimoria

Change(s) Addressed: Economic &amp; Social Equity

Jeroo Billimoria grew up in Mumbai, India. Drawn to children, she studied social work and founded Meljol, an organization that provides opportunities for children to make friends across classes and castes and become leaders in their communities. Jeroo also gave out her phone number and took calls for help from street children, which led her to found Childline. Starting with just \$6,000, she built a national institution that in 5 years fielded more than 10 million calls for assistance in India's 74 largest cities. She then founded an international organization, Child Helpline International, which now supports help lines in 153 countries. In 2005, Jeroo founded Aflatoun to apply the same international replication model to Meljol's child empowerment curriculum and in-school savings and financial education program. This program, symbolized by an "Aflatoun" (explorer) who helps children envision a better future and act on their dreams, promotes a culture of saving, builds skills for using money and develops responsibility and pride.

Key accomplishments as of 2010: Child Social and Financial Education through Aflatoun now reaches over 540,000 children in over 5,000 schools in 32 countries worldwide. Through Aflatoun, 40% of students in the program save small amounts weekly (ca. \$0.10). In 2008, Aflatoun children started over 80 social campaigns and almost 300 small enterprises.

**Ashoka Foundation**

URL: <http://www.ashoka.org/>

Location: Arlington, Virginia (Global headquarters)

Number of employees: 160 staff in 25 regional offices throughout Africa, the Americas, Asia, Europe, the Middle East, and North Africa

CEO/Leader: Bill Drayton (CEO and Chair), Diana Wells (President)

Type: Social Investment

Ashoka is a registered 501c3 not-for-profit organization in the United States and is the global association of the world's leading social entrepreneurs—men and women with system changing solutions for the world's most urgent social problems. Founded in 1980 by Bill Drayton in Washington, DC and since 1981, Ashoka has elected over 2,500 leading social entrepreneurs as Ashoka Fellows, providing them with living stipends, professional support, and access to a global network of peers in 70 countries. Ashoka's CEO and Chair is Bill Drayton. Ashoka has grown to an association of over 2,000 Fellows in over 60 countries on the world's five main continents. Ashoka is spread across various Geos - Latin America, Africa, Asia, Central Europe, Western Europe, East Asia, and the Middle East.

**Success Story:**

Empowering young girls- Betty Makoni (Zimbabwe)

In mainstream Zimbabwean society, there are few spaces, either public or private, that allow girls to express themselves on equal footing as boys or men. Through her organization, Girl Child Network (GCN), Betty is organizing girls clubs across Zimbabwe aimed at empowering girls to fight back against sexual exploitation, poverty and violence.

Betty's Impact- Today, GCN serves 30,000 girls and has established 450 girls clubs in 49 of Zimbabwe's 58 districts. She is working to expand the Girl Child Network outside the country to the southern Africa region. Betty has publicly exposed alleged sexual crimes by powerful men, including by officials in President Robert Mugabe's government.

**Acumen Fund**URL: <http://www.acumenfund.org>

Location: New York, NY, USA

Number of employees: ~53

CEO/Leader: Jacqueline Novogratz

Type: Social Investment

Acumen's mission is to create a world beyond poverty by investing in social enterprises, emerging leaders, and breakthrough ideas. Acumen Fund was incorporated on April 1, 2001, with seed capital from the Rockefeller Foundation, Cisco Systems Foundation and three individual philanthropists. Since then Acumen's network of investors and advisors has grown to include a wide range of individuals and organizations who share Acumen's belief in using entrepreneurial approaches to solve the problems of global poverty. They mainly invest in the following sectors – Health, water, housing, energy and agriculture and in the following regions- India, Pakistan, East Africa and West Africa. Acumen invests in early stage firms with a proof of concept in place and around 90% of Acumen's funds come from Philanthropic sources. Acumen's typical asset class has 30% debt and 70% equity and it looks for 3 main investment criteria - good social impact, financial viability and scalability.

**Success Story - Vision Spring**

**Objective** - Over 400 million people across the developing world suffer from presbyopia. Poor eyesight in many cases means the difference between earning a livelihood and not. Clear vision is critical for continued worker productivity.

**Innovation** - VisionSpring trains Vision Entrepreneurs to operate a microfranchise, traveling from village to village and conducting vision camps, checking eyesight and selling glasses. One pair, with a case and cleaning cloth, costs from \$2.50 to \$4.

**Impact** - VisionSpring's Vision Entrepreneurs have sold more than 360,000 eyeglasses, across four continents and eleven countries, since 2001. Studies indicate that each pair of eyeglasses sold enables an average \$106 in increased earnings for the customer.

**Endeavor Global**

URL: <http://www.endeavor.org/>

Location: headquartered in New York City with a satellite office in San Francisco

Number of employees: ~30 (Management Team)

CEO/Leader: Linda Rottenberg

Type: Social Investment

Established in 1997, Endeavor ([endeavor.org](http://endeavor.org)) is the global nonprofit that pioneered the concept of High-Impact Entrepreneurship in emerging markets. A growing movement, High-Impact Entrepreneurship is widely recognized as the key driver to sustainable economic development--creating jobs, prosperity, and a culture of innovation and investment.

As leaders of the movement, Endeavor has set the standard for identifying and supporting entrepreneurs with the greatest potential for impact. In 13 years, Endeavor has screened and provided feedback to 23,000+ candidates and selected 604 High-Impact Entrepreneurs from 358 companies. Supported and mentored by our growing network of 1,000+ top local and global business leaders, these entrepreneurs have created over 130,000 high-value jobs and generated more than \$3.5 billion in annual revenues.

Beyond this impact, Endeavor's support catalyzes a chain reaction in the larger economy--driving investment, creating role models, and fostering the conditions for the next Silicon Valley in Rio or Capetown, Cairo or Jakarta. It is what led Thomas Friedman to hail our model as the “best anti-poverty program of all.”

Headquartered in New York City, Endeavor runs 10 independently-run country affiliates across Latin America, the Middle East, and South Africa, with plans to expand to 20 countries by 2015.

Success Story: Urman

Objective - Create a globally-competitive school and office supply business.

Impact - Urman has transformed a small mom-and-pop shop that sold leather-bound organizers into one of the most dominant producers of student notebooks, office supplies and accessories in Mexico. URMAN is a well-recognized “rags to riches” success story, outperforming global heavyweights like Kimberly Clark in the Mexican market and building the potential to expand internationally.

**Omidyar Network**URL: <http://www.omidyar.com>

Location: Redwood City, CA (USA)

Number of employees: ~20

CEO/Leader: Pierre and Pam Omidyar in 2004

Type: Social Investment

Established by eBay founder Pierre Omidyar and wife Pam, the Omidyar Network manages \$383M in investments and grants. Omidyar is based in Redwood City, CA and Mumbai, India. It invests in both profit and non-profit businesses, and focuses on providing access to capital for people in the base of the pyramid in developing countries in India and sub-saharan Africa – through microfinance, social venture capital and property rights. In the developed world, Omidyar focuses on engagement and participation in media, markets and government.

Omidyar seeks to make investments greater than \$1M, and sources deals from their network of partners and contacts. Investment criteria include impact, alignment with mission of improving standard of living, opportunities for scaling, leadership quality and innovation potential.

Success story: Janaagraha

(Sector: non-profit, govt. transparency, geography: India, committed amount: \$3M)

Janaagraha is one of the most respected and effective government transparency organizations in India. With Omidyar Network's support, Janaagraha will extend its model beyond Bangalore to other cities and towns in India. The funding will also support Janaagraha's online civic engagement platform, iJanaagraha, and its bribe reporting website, "I Paid a Bribe." The iJanaagraha portal aims to initiate positive social change by building networks of communities and local civic bodies, providing data on urban issues, and fostering civic awareness.

Over the past decade, Janaagraha has developed and refined a model to improve civic engagement and urban governance in Bangalore. The organization's approach focuses on coordinating citizens at a local level to hold responsible parties to account. To track the progress and effectiveness of its model, Janaagraha has developed an innovative quality-of-life indicator that tracks improvements in key dimensions of urban life, as well as a quality-of-citizenship metric that assesses citizen engagement, empowerment, and volunteerism in the community.

**Echoing Green**

URL: <http://www.echoinggreen.org>

Location: New York City, NY (USA)

Number of employees: ~20

CEO/Leader: Cheryl Dorsey since 2002

Type: Social Investment

Echoing Green was established in 1987 by the senior leadership of General Atlantic, LLC. Named after a William Blake poem, Echoing Green invests in and supports outstanding emerging social entrepreneurs to launch new organizations that deliver bold, high-impact solutions. Led by CEO Cheryl Dorsey and based in New York city, Echoing Green has invested nearly \$30 million in seed grants to close to 500 social entrepreneurs. Echoing Green Fellows have sparked social change in forty-two countries on five continents.

A recent study found that Echoing Green Fellows' organizations have raised close to \$1 billion in additional funding, delivering a return on investment (ROI) of approximately 44 times Echoing Green's seed funding. Echoing Green invests in all sectors and all geographies.

Success story: Make the road by walking (MRBW)

(Sector: civil human rights, geography: US, committed amount: \$60K)

Make the Road by Walking is a membership-led organization based in Bushwick, Brooklyn that fights for justice and opportunity through community organizing on issues of concern. They promote economic justice and participatory democracy by increasing residents' power to achieve self-determination through collective action.

Since its inception, MRBW has scored some major victories. The Economic Justice and Democracy Project required New York City to conform to federal law and provide translation services to non-English speakers in all of its food stamp, welfare and Medicaid offices. The Workplace Justice Project forced dozens of neighborhood employers to pay over \$100,000 in illegally withheld wages to garment workers, and continues to fight for workers' rights and improved conditions.

**Inventure Fund**

URL: <http://www.inventurefund.org>

Location: Los Angeles, CA (USA)

Number of employees: ~6

CEO/Leader: Shivani Siroya since 2008

Type: Social and Impact Investment

Led by CEO Shivani Siroya, Inventure Fund connects individual investors with bottom of the pyramid entrepreneurs. Inventure aims to achieve both financial and social returns through its operations. Inventure invests in India, Mexico and West Africa – these choices based on areas where micro-lending and microfinance are well established. The focus sectors are small business expansion, job creation, sustainable community development. Inventure invests in firms that have been doing business for 2-3 years with a proven track record.

Success story: In just 6 months, InVenture has invested in 35 entrepreneurs in 3 countries. This constitutes 35 micro and small business owners who got the opportunity to expand their businesses, move towards financial independence, and make positive changes in their communities. Each entrepreneur has paid back his/her original principal, is meeting returns of 15% or higher, and is reinvesting in local social causes like public health and vocational training for school girls.

**Gray Ghost Ventures**

URL: <http://www.grayghostventures.com>

Location: Atlanta, GA (USA)

Number of employees: ~9

CEO/Leader: Bob Pattillo since 2003

Type: Social and Impact Investment

Gray Ghost Ventures (GGV) first started as the Gray Ghost Microfinance Fund (GGMF) in 2003. Founded by Robert (Bob) Pattillo, a real estate entrepreneur who sold his business in 2003, GGMF was established as a result of Bob's successful work with Deutsche Bank Microfinance Fund and ACCION international. GGV runs as a family office investing Bob's personal wealth for two of its three major focus areas: microfinance and affordable private schools. For the third – social venture investment – GGV sources capital from DOEN Cooperatief, a Netherlands based fund, and focuses on rural information, communication and technology solutions for the Indian subcontinent. Besides these three focus areas, GGV is piloting a new First Light fund focused on incubating social businesses.

Success story: Cellbazaar

Seeded in the MIT Sloan Media Lab, Cellbazaar was created to directly connect buyers and sellers in a marketplace through mobiles. Kamal Quadir (the brother of Iqbal Quadir, founder of Grameenphone) realized that the Bangladesh rural population would not have access to cheap internet-connected computers for some time, and that mobile was the rapidly penetrating technology. Cellbazaar facilitates transactions, creating markets where there were none previously because of lack of information.

Gray Matters Capital invested in Cellbazaar at the seed stage. Cellbazaar was acquired by Telenor in 2010.

An example of Cellbazaar's success: Cellbazaar enabled Abdul, a jackfruit farmer in Bangladesh, to know the market price of the fruit by posting on Cellbazaar's market. This enabled him to negotiate better with a ruthless trader at the local market, and thus command a higher income.

**Minlam Asset Management**URL: <http://www.minlam.com>

Location: New York City, NY (USA)

Number of employees: ~20

CEO/Leader: Michael Parker

Type: Social and Impact Investment

Minlam Asset Management is an investment manager specializing in the microfinance area. The management team brings depth of experience in emerging markets debt financing and currency management to the task of providing funding for local microfinance firms. Stringent due diligence ensures that portfolio firms are able to provide both high profitability and low risk investments. The team also looks for evidence that portfolio companies have broad support beyond what Minlam can provide.

The typical target MFI will have a minimum loan portfolio of \$5 million, be operationally self-sufficient, have efficient operations and independent governance, and have strong management. Loans are made in increments of \$500k to \$5 million, are denominated in the local currency, for term length up to 36 months. Collateral required is flexible, they offer both senior and subordinated debt and interest rates are intended to be competitive with local markets.

**Success Story:**

Since Minlam does not lend directly to the end user of microfinance credit, success for the firm can best be seen in the ability of management to create a competitive advantage through its strategy for placing investments throughout the globe in the local currency. Lending in US dollars or requiring cost-inefficient currency swap strategies places additional cost on the recipient microfinance lenders in the form of foreign currency risk in their operations and lower returns. Minlam is able to achieve this through careful allocation between traditional and emerging markets, keeping an eye on macroeconomic factors such as balance of payments and currency appreciation.

**Root Capital**

URL: <http://www.rootcapital.org>

Location: Cambridge, MA (USA), field offices in Central/South America, Africa, Haiti

Number of employees: ~40 (HQ), ~25 (field)

CEO/Leader: William Foote since 1996

Type: Social and Impact Investment

Root Capital's theory of change is to provide capital and financial training to small and growing businesses (SGBs) operating in poor, environmentally vulnerable places. By doing so, Root Capital enables SGBs to expand their operations, generating higher and more stable household incomes for small-scale producers and supporting sustainable rural communities. Over time, Root Capital aims to demonstrate the financial viability of rural SGBs and catalyze dynamic capital markets to serve them at scale.

Root Capital is positioned to address the needs of rural grassroots businesses (SGBs) targeting the agricultural and natural products industries throughout Latin American and Sub-Saharan Africa. Regional offices in Costa Rica, Guatemala, Kenya, Mexico, Nicaragua, and Peru enables Root Capital to efficiently service existing clients and respond to the needs of potential borrowers. About 70% of the portfolio is in the coffee sector. Root Capital's success in lending to coffee enterprises has relied on a deep understanding of sector characteristics, including value chain dynamics and crop seasonality. Root Capital has begun looking at diversification toward riskier investments, such as geographic locations suffering post-conflict or post-disaster and new markets such as fruit and vegetables.

**Success Story: Gulu Agricultural Development Company**

The Gulu Agricultural Development Company was formed in Uganda to restart local cotton production which had been devastated by a long-running insurrection. After receiving a loan of \$2.2 million from Root Capital along with the Acumen Fund, a local cotton gin was refurbished and brought back online and local farmers received education on harvesting techniques. Thousands of farmers in the area have been helped by the increased economic opportunities that GADC has helped make possible.

**Draper Richards Foundation**

URL: <http://www.draperrichards.org>

Location: San Francisco, CA (USA)

Number of employees: ~8

CEO/Leader: Jenny Shilling Stein since 2002

Type: Social Investment

Draper Richards Kaplan Foundation (DRKF) was founded in 2002 by prominent venture capitalists William H. Draper III and Robin Richards Donohoe. DRKF provides social entrepreneurs with grants of \$100K annually for 3 years (a total of \$300K).

DRKF is a foundation with a Silicon Valley Venture Capital twist. DRKF awards up to 6 grants a year, does not look for financial return, and remains heavily engaged with the funded entrepreneurs. The grants are extremely competitive, and a VC-like screening process is employed.

Success story: Room to Read

Founded in 2000 by Microsoft executive John Wood, Room to Read gives children in the developing world opportunities for education by helping build schools, establish bi-lingual libraries and publish children's books in local languages. Room to Read also builds computer labs and funds scholarships for girls. Room to Read has operations in India, Sri Lanka, Nepal, Cambodia, Vietnam, Laos as well as South Africa and Zambia.

Room to Read has impacted over 1.7M children through 440 schools, 5100 bi-lingual libraries and 4000 scholarships for girls. It has received the Fast Company/Monitor Group "Social Capitalist Award" 4 times, and the Skoll Award for Social Entrepreneurship twice.

**SJF Institute/Investors' Circle**URL: <http://www.sjf institute.org>

Location: San Francisco, CA (USA)

Number of employees: ~20

CEO/Leader: Bonny Moellenbrock

Type: Social and Impact Investment

SJF Institute is a nonprofit that works to connect, inspire and accelerate impact entrepreneurs and the fields that support them. In addition to the venture capital arm of SJF Ventures, the group also leverages upon Investors' Circle's consortium of 150+ angel investors. These investors are seeking to support profitable entrepreneurial ideas that aim to create positive social and environmental impact. The investments are primarily in ideas involving the United States market across 6 different sectors – Energy & Environmental Solutions, Sustainable Consumer Products, Education, Community & Economic Development, Health, Biotech & Wellness, and Social Media & Software.

The investments are traditionally in ideas that have proven market traction, the investors involved in Investors' Circle are aware of the current exit timeline and liquidity limitations in the impact investing area. The investor expectations are thus set at more realistic levels through the concept of 'Patient Capital'.

Success story: IC20

With more than 150 angel investors, the success of Investors' Circle is better seen through a set of firms rather than any one firm. The IC20 is a list maintained by Investors' Circle showcasing their most successful companies in terms of financial and social impact. All of these companies have their revenues driven by socially and environmentally responsible practices. These companies have created around 4785 jobs, received \$99 Million in capital (with \$2.2 Billion follow on capital) and have all provided successful exits. This list can be viewed at <http://www.ic.accelhost.com/accelsite/media/2245/IC%2020%20Summary.pdf>

## Addendum B

Below are questions our team posed during interviews. We filled in additional information from the firm's website. The responses to these questions are integrated in various sections of the paper.

### Objective & Structure

1. Which is higher priority for your firm, Social Impact or Financial performance?
2. What unique skills does your firm bring to the investment process?
3. Who are your stakeholders (LPs, endowments)?

### Identifying and Choosing Investments

1. Do you have preference in specific sectors for investments? Specific geographical region?
2. Do you prefer early stage, growth stage or later stage investments?
3. What is the time horizon of the fund?

### Investment Process

1. What special problems do you anticipate encountering investing in impact projects that are different from normal projects?
2. Do you have a preference towards only equity based financing or also debt based financing to hedge any possible risks? What is the time period from start to finish (on an average) for a social impact investment?
3. How are the candidates for investment being sourced? Who are the key players in sourcing the deals?

### Investment Relations/Management

1. How are you planning to actively engage with your investments? How closely do you monitor/manage your investments?
2. What resources do you need for managing the portfolio? Are there existing resources for operational mentoring already available?
3. Do you use IRIS or GIIRS to measure impact success in your portfolio? How easy is it to use these tools? Why do you think more investors are not using it?

### Exit

1. What is your preferred exit scenario and timeline for investments?
2. What tolerance level do you have in your impact floor and financial floor if one or both of the factors is (are) severely compromised at some point?

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