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**Research Report**

## The future of funding for social enterprises

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# *Kiel* **Policy Brief**

## **The Future of Funding for Social Enterprises**

**Paul Chong and Linda Kleemann**

No. 34 | September 2011



## **Executive Summary\***

The funding of social enterprises has undergone significant transformation over the last 20 years shifting from direct grants provided by government and philanthropic foundation sources, to earned revenues from a broader range of sources.

In addition, the global economic crisis in 2008 has created new challenges and opportunities for the social enterprise sector. Fiscal tightening by traditional social funding sources was exacerbated by investor wariness of investments without clear reporting transparency and impact accountability. However, the high volatility of conventional markets has led investors to consider diversification strategies and counter-cyclical investments, benefiting many types of social enterprise.

This paper describes the challenges and opportunities for funding faced by the social enterprise sector post-economic crisis. It also proposes recommendations for social enterprise managers and policy makers that are intended to increase the pool of funding available to the social enterprise sector.

## **Introduction**

The purpose of this paper is to provide background on the current situation and future scenarios of social enterprise funding; with an emphasis on how the funding environment has changed since the 2008 global financial crisis. Although funding has retracted since the economic downturn, many of the systemic issues faced by the social enterprise sector have remained unchanged. The allocation of capital is still challenged by a lack of efficient intermediation, investment infrastructure is still fragmented in key areas, and social enterprises still face a lack of sufficient absorptive capacity. Initiatives to address these challenges are presented in this report.

Despite the negative economic outlook and the challenges faced by the social enterprise sector, there are many reasons for optimism. Long term funding trends are on an upward trajectory, advancements in technology and social networking have greatly aided the communication of social causes, and stagnant growth in the private sector has resulted in significant human capital to shift towards the social sector.

The crisis has created a unique opportunity for the social enterprise sector to establish itself as a mature and sophisticated destination for capital. This report provides a high-level overview of the major financial challenges and opportunities faced by the social enterprise sector. It is also intended to act as a primer for the 2011 Global Economic Symposium expert panel session entitled:

### ***“Funding Social Enterprises: Out of the Ashes of the Economic Crisis?”***

The final purpose of this paper is to provide a framework from which a set of Global Economic Solutions will be developed.

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\* This paper is intended to serve as a background paper for the symposium session “*Funding Social Enterprises: Out of the Ashes of the Economic Crisis?*” at the Global Economic Symposium 2011 in Kiel, Germany.

### Definition of Social Enterprise

There is no universally accepted definition for *Social Enterprise*. A recent report published by ClearlySo defines it as:

“A social enterprise can be defined as an organisation or venture which achieves its primary social, ethical or environmental mission using business methods. From an investment perspective, social enterprises must ‘principally’ direct financial surpluses back into the business or the cause it serves.”

*Source: ClearySo, Investor Perspectives on Social Enterprise Financing (July 2011)*

The Journal of Social Entrepreneurship includes:

“. . . both for and not-for-profit organisations, as well as public sector bodies, though [social enterprise] excludes all organisations whose primary purpose is profit-maximisation, irrespective of whether they also aim to do social good.”

*Source: Journal of Social Entrepreneurship*

Finally, the *Social Enterprise Alliance* defines social enterprise in the following way:

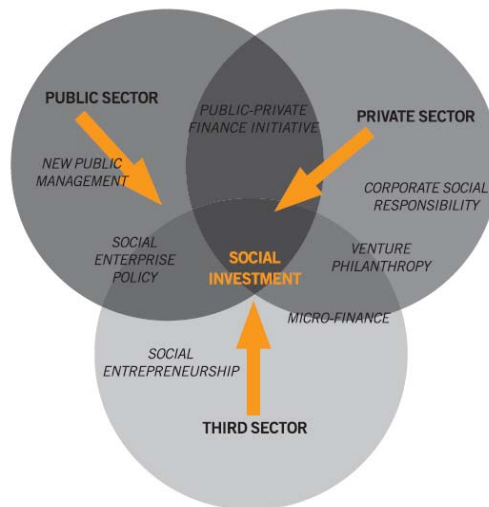
“A social enterprise is an organization or venture that achieves its primary social or environmental mission using business methods [...] the social enterprise movement includes both non-profits that use business models to pursue their mission and for-profits whose primary purposes are social.”

*Source: Social Enterprise Alliance*

### Funding Landscape

Sources of social investment can be roughly grouped into three primary types: public sector, private sector and third sector (Figure 2). There are significant areas of overlap between these three sources of social investment, resulting in a number of emerging hybrid forms of funding. Driven by a wave of innovation and social entrepreneurship, new funding strategies are being developed to support social enterprise start-ups, growth and increases in organisational scale (Nicholls, 2004, 2005, 2006a, 2006b).

Figure 2: Social Enterprise Funding Landscape



Source: The Landscape of Social Investment, Skoll Centre (March 2008)

### Recent Trends and Developments

The funding of social enterprises has undergone significant transformation over the last 20 years. Rangan et al (2008) describes how funding has shifted from direct grants provided by government and philanthropic foundation sources, to earned revenues from a broader range of sources (including public, private and individual).

The global financial crisis has brought the issue of funding to the forefront of challenges faced by the social enterprise sector. The resulting squeeze in funding sources is a reversal of long-term macro trends which saw significant advancement in both the amount of capital attracted by the sector and the breadth of sources providing capital. Notwithstanding the challenges posed by the economic downturn, a number of opportunities have emerged for the social sector as well.

### Key Challenges

Nicholls (2008) identifies 15 different social investment challenges in his 2008 study at the Skoll Centre. These can be categorized into three types of challenges: unlocking investment from financial sources, developing sector supporting infrastructure/policy, and enhancing social enterprise capabilities.

### Unlocking Investment from New and Traditional Sources

The lack of mechanisms to connect capital and impact investment opportunities is caused in large part by an investment industry structured around the historical binary of philanthropy (for impact) and investment (for returns), with optimization around each independently. As a result, the market for impact investing activity that integrates doing well and doing good lacks

sufficient intermediation—whether it is clearinghouses, syndication facilities, independent third-party sources of information, or investment consultants. As a result, search and transaction costs are high, with fragmented demand and supply, complex deals, and underdeveloped networks.

Few institutions exist that can offer advice to people looking to do something different. Some fund managers are reluctant to seek more than just financial return since, as one of them put it, “people don’t want hippies managing their money.” Conservative investment advisors lack incentives to take risks in their investment approach and are concerned that incorporating social and/or environmental considerations might violate their fiduciary responsibility. As Steve Schueth of the U.S. investment advisory firm First Affirmative Financial Network describes it: “The real issue is not about products or markets; it’s about attitudes in the board room and among advisors. . . . There’s plenty of quality product on one end of the hourglass and lots of prospective clients on the other end. In the middle, there’s a bottleneck and that bottleneck is the investment professionals in this country.” A financial services provider in Europe made a similar point before the financial markets plummeted in 2008: “Trustees are extremely conservative and are more prepared to invest in a hedge fund they don’t understand than to invest in a mission-driven fund they don’t understand.”

The bifurcation of financial return and impact inhibits the integration inherent to impact investing. If history is part of the barrier, youth may be one element of the change. As one asset manager notes, “We need a new generation of money managers who are open-minded to the possibility that values and returns are not bifurcated.”

Well-developed informal networks could compensate for this lack of formal intermediation. But those networks are underdeveloped because actors do not identify as part of an industry and therefore have difficulty trying to find peers. As Stephen DeBerry at Kapor Enterprises notes, relevant interest groups need to be developed further: “We need to form meaningful categories of interest so that existing and new impact investors can effectively find their relevant peers. Silicon Valley venture investors have done this organically and effectively. We should do the same.”

Without a mechanism for aggregation, individual investors struggle to find investment opportunities that are at sufficient scale to justify the fixed costs incurred for sourcing the investments and conducting due diligence. Pools of capital are often large and investors must write big checks, while individual deals are relatively small. This makes impact investing less attractive to investors who are unable or unwilling to invest the additional effort required to source what may be relatively smaller deals.

### **Developing Infrastructure that Encourages Social Investment**

Still an emerging industry, impact investing lacks the models, theories, policies, protocols, standards, and established language that would enable it to flourish. Many investors and intermediaries do not understand the implications of social and environmental considerations on the underlying risk of an investment opportunity—and there is a preconception that there must be a fundamental trade-off between financial returns and impact. But there are no

metrics or ratings agencies to help make relative financial risk and social or environmental impact more transparent. Furthermore, the financial performance of many impact investments is uncertain, even though these investments might meet or beat return benchmarks. These factors all make valuation quite challenging.

The market environment and infrastructure (e.g., regulatory, legal, tax) is highly structured around conventional investing, which constrains actors who are trying to engage in impact investing. For example, contracts or charters may require modifications in order to allow investors to consider social and environmental outcomes. Furthermore, the distribution channels that help syndicate rated deals that are on approved buy lists do not help this new class of investment, which may not conform to standard channels. Distribution channels and custodial arrangements—in effect, the plumbing of the securities industry—often preclude interested investors from purchasing and clearing investments and custodians may be unwilling to hold such nonstandard assets.

The absence of coherent identification as part of an industry results in the use of varied terminology and diverse approaches causing difficulty in communicating. The lack of universally accepted vocabulary and market segmentation makes it difficult for impact investing actors to communicate about opportunities. The diversity of approaches and ways of describing them makes it difficult for actors to locate themselves in the impact investing ecosystem and to identify potential partners. As Preston Pinkett, the director of Prudential Social Investment, which had \$400 million in investment commitments before the 2008 market downturn, explains: “It takes consistency in language to create a business. The biggest challenge is to have a coherent set of terms and phrases that are clearly defined and have clear meaning.”

### **Enhancing Social Enterprise Capacity and Capabilities**

The social enterprise sector suffers from a lack of sufficient absorptive capacity. This is best illustrated by the limited number of enterprises with innovative, scalable models. Capacity of effective management is another challenge that persists across the sector.

Based on interviews conducted by Monitor (2008), the lack of sufficient absorptive capacity for capital will become an increasingly pressing challenge in the sector. Funding trends in emerging countries suggest that, conceivably in the near future, absorptive capacity could become a significant sector bottleneck; it is already a challenge in such markets as India, where lots of capital is seeking deals.

“Some investors are finding that there are few businesses with proven investable business models and that they are stopping at the same 50 doors as other investors.”

*Source: “Market-Based Solutions to Social Change in India”, Monitor (2008)*

## Future Opportunities

Notwithstanding the numerous challenges faced by the sector, there are a number of opportunities to be optimistic about. The following points are adapted from Investing for Social & Environmental Impact, Monitor Institute (2009):

### Growing Interest among Capital Providers

An economic crisis, like in 2008, that comes with high volatility in conventional markets is driving investors into new sectors. This is a chance for social enterprises. The desire for diversification is leading investors to look at sectors like microfinance, which tend to be less correlated with the broader market (Kraussa, N. and Walter, I., 2008). In particular, much of the interest in impact investing is being driven by a growing set of investors who have recently become very wealthy and are seeking a new approach to money management that enables them to also “make a difference.” As Charles Ewald of San Francisco-based New Island Capital points out: “This is the first time that so many enormous fortunes have been created by people so young. They have institutional scale and a long horizon.” And as Chris Wolfe, a private banker at Merrill Lynch, explains, “The ultra-high-net-worth individual category has been a driver and leader in this type of investing since they have the capacity, ability, and time to understand what impact investing means.” Some of these investors are also increasingly disenchanted with mainstream investment products (and financial capitalism at large). Impact investing can be more appealing to them than conventional models of philanthropy and investing, and these investors have sufficient scale and flexibility to be early movers in the space.

Interest is also being driven by an increasing focus on rapidly growing markets such as India, China, and South Africa, where impact investments potentially have a fast and large public benefit through opportunities like building basic infrastructure or spurring economic development constrained by access to capital. There are also investment opportunities focused on providing products and services to the poor in general, both in emerging markets and in developed countries as well (e.g., in inner cities).

Increasingly, consumers are incorporating values-driven considerations into their purchasing and investment decisions, leading to investment opportunities in areas with increased demand such as organic, fair trade, and green products. And like consumers, investors are also seeking to make investments that are aligned with their values. As Scott Budde, head of social and community investing at the U.S. pension fund TIAA-CREF, explains, “Client demand is a key driver behind TIAA-CREF’s socially motivated investing strategies. The fact that both social screening and proactive investing programs continue to yield competitive returns allows these strategies to thrive.” Behind the concept of shared value (e.g. Porter and Kramer 2011) is the idea that “doing good” can be part of profit maximization if done strategically and with a long-term view.

At the same time, interest in impact investing in some regions and sectors has also been pushed by regulatory incentives and mandates, such as the Community Reinvestment Act in



the U.S. and the Dutch Green Funds Scheme. There is also great interest in impact investing coming from investors who anticipate future changes like carbon pricing and want to take advantage of an under-priced opportunity. As David Chen of the investment firm Equilibrium Capital sees it, “The policy environment in Europe has created awareness around topics that the U.S. is just beginning to catch up to.”

### **Greater Recognition of the Need for Effective Solutions to Social and Environmental Challenges**

Angel Garcia (in OECD, 2008) has recognized growing inequality within countries as the major global concern. This social challenge is increasingly visible (through social unrest, disconnection between the elite and working class population, etc.). Additionally environmental problems and climate change on the forefront call for practical solutions with ever increasing urgency. Not enough, the impacts of climate change are predicted to fall disproportionately on the poor thereby increasing inequality. In urban centres around the world, dramatic inequity is barely screened by the security gates that separate the estates of the very wealthy from the shantytowns of the very poor. The melting Arctic provides a salient reminder that carbon emissions are threatening the very ecosystem that humans depend upon. Headlines make these issues harder to ignore, whether they're about poverty in the U.S. (Hurricane Katrina in 2005) or the gradual mainstreaming of microfinance for the poor (the Nobel Prize won by Grameen Bank founder Muhammad Yunus in 2006). Similarly, growing publicity about climate change has been spurred in part by Al Gore's book and movie, “An Inconvenient Truth” and the Nobel Prize awarded to him and the UN Intergovernmental Panel on Climate Change in 2007. These daunting challenges are leading some investors to seek new approaches and investment opportunities that can help provide solutions.

### **A Steadily Developing Track Record with Early Successes**

Early successes in community development, microfinance, and clean tech are attracting positive and extensive popular press and broader interest in social enterprise funding. Lucrative social investments have attracted significant investor interest in the space. The Compartamos initial public offering provided proof of financial viability, while also yielding original investors an internal rate of return of 100 per cent a year compounded over eight years; return on equity in 2007 was more than 45 per cent (Rosenberg, 2007). A board director at Banco Compartamos, Álvaro Rodríguez Arregui, has now partnered with Michael Chu, formerly of Kohlberg Kravis Roberts and former president and CEO of microfinance leader ACCION International, to launch IGNIA Partners, a venture capital firm focused on health, housing, and education companies that serve the poor in Latin America. These early successes are important for attracting capital, even though in these cases the trade-off between maximizing profit and social aims seems to be won by traditional business view.

### **A Flock of Talent**

Young professionals are increasingly interested in impact investing and in creating businesses that have social impact. For example, when J.P. Morgan launched its social sector finance unit in 2007, its leader Christina Leijonhufvud reports, “We received about 1,000 résumés from employees in other units who were interested in positions with our group or contributing their time to our efforts.” Net Impact, an international network of MBAs and other graduate students and professionals interested in social enterprises, now has more than 10,000 members. At Harvard Business School, more than 20 per cent of students in 2008 were members of the student-led Social Enterprise Club. The rise of the concept of social entrepreneurship reflects significant interest in working in this arena and has, in turn, created greater institutionalization of academic and professional resources for those pursuing related activities. This infusion of talent will lead to higher-quality investment opportunities as well as more effective intermediaries and service providers over time.

### **Develop New Sources of Funding for Social Business**

Rangan et al. (2008) identify key demographic and economic trends that will influence the future sources of social funding. Three specific trends are expected to create new funding sources. First, the aging of baby boomer generation creates an intergenerational transfer of wealth. Rangan et al. describes an intergenerational transfer of wealth occurring between elderly adults reared during the depression and aging baby boomers and their families, resulting in an estimated \$10 trillion transferred over the next 50 years. This unprecedented transfer of inheritance and wealth is expected to drive significant increases in individual donations and giving.

Second, the concentration of ‘new’ wealth resulting from the dot-com and technology booms has created a new source of social funding. Rangan et al points to the 3% of US households with annual incomes exceeding \$200,000 as having a huge impact on philanthropic giving (accounting for over two-thirds of individual charitable giving in the US). Additionally, self-generated wealth from philanthropists such Bill and Melinda Gates, Bill Clinton and Oprah Winfrey, is redefining how social funding is distributed and applied.

Last, expected future increases in government funding, directly or indirectly, through incentives to consumers using social services will change the dynamics for accessing social funding from government sources. Rangan et al state that, in the last 20 years, government funding has evolved from direct grants and contracts to vouchers and subsidies to consumers. This has resulted in a blurring between revenue from government payments and revenue from other profit-seeking activities. The implications to social enterprise are greater potential competition for government funding and an overall increase in public money directed towards social subsidies.

These five opportunities provide significant reason for being optimistic about the future funding of social enterprise. The remainder of this report is focused on the current

challenges faced by the sector, and proposes solutions that address the most pressing social enterprise funding issues.

### **Unlocking Investment from New and Traditional Sources**

Funding of social enterprises has undergone a significant evolution over the last 30 years. Revenue sources have “moved towards the market” (Leonard, et al., 2008), through increases in earned revenue, government vouchers/subsidies, and partnerships with private businesses.

It is important to note that funding sources differ dramatically by social enterprise subsector. For example, health care related social enterprises account for a disproportionate share of the sector’s fee-for-service revenue (NCCS, 2007), while policy development and implementation programs in the US are largely dependent on private donations and foundational grants.

The Monitor Social Investment Report (2008) lists seven initiatives that address the lack of efficient intermediation within existing social enterprise financial sources.

1. Industry-defining funds that can serve as beacons for how to address social or environmental issues
2. Substantial, risk-taking capital in catalytic finance structures
3. Dedicated impact investment banking capabilities
4. “Pull” existing intermediaries into impact investing by making business commitments (to stakeholders and CSR initiatives)
5. Create funding and investment clubs focused on specific themes
6. Backable fund managers
7. Financial products that increase accessibility

In this paper, three key initiatives are addressed: creation of social enterprise sector-defining funds, establishment of social enterprise investment clubs, and creation of innovative financial products for social investment.

### **Social Enterprise Sector-Defining Funds**

Describing what could catalyse the industry, Jason Scott of New York-based EKO Asset Management Partners says: “Create a really big fund through credible organizations guaranteeing 5 to 8 per cent to investors, operating the right way, using some philanthropic capital (say, \$10 million), monitoring progress, and with clearly stated social outcomes such as 10 million tons of carbon reduced or 1 million jobs created.”

A small number of large scale investors, such as sovereign wealth funds or even universities, could trigger something similar on their own. The results for the industry will be greatest if there were a high level of visibility and influence for the fund. As Preston Pinkett, director of Prudential Social Investment, describes it: “In the best of all worlds, the 10 largest foundations—plus Harvard, Yale, Princeton—would decide to invest all of their endowments

in the social impact space. This would create a chain of events that would create the required market . . . or at least 88 per cent of it.” That said, a fund may be most readily established by strategic investors whose reputation makes the ripple effects across the industry most credible and powerful. A good example of this type of “800-pound gorilla” could be CalPERS (the California Public Employees’ Retirement System); when it starts strategically allocating to a sector, it influences the behaviour of a wide range of other actors.

Ideally large funds would be developed taking different approaches, thus creating a healthy amount of competition between funds. A single marquee fund could also accomplish some of these objectives, though other significant players may be disinclined to emulate it since “eagles don’t flock.”

In another approach to this initiative, an entrepreneur or existing fund could launch a fund of funds that provides investors with an accessible vehicle for putting capital to work in credible impact investments and widening the investor base beyond the relatively sophisticated investors who currently have the resources and conviction to seek out and vet investments.

### **Social Enterprise Investment Clubs**

Two types of clubs might be developed. One form would involve only investors with a goal of aggregating investors to improve deal flow. For example, Investors’ Circle has provided an important forum for a subset of early-stage investors to gather.

A broader model of a club might also include a network of technical assistance providers for the social and/or environmental aspects of their investments, enabling investors to assess investments with lower transaction costs. The network could include research institutions, community organizations, environmental engineers, and activists who can help to develop and implement sustainable impact in the chosen investment area, potentially as an online business that allows access to targeted expertise. This would not only enable investors to collaborate more effectively but would also help potential partners overcome what can be an aversion to capitalism as a means to achieve their mission.

For either type of club, success will require thoughtful collaboration, a long-term perspective on the part of investors, and putting time in to build the network, which may not be economically justified in the short-term.

A newer effort underway along these lines is a working group formed in 2007 at a meeting hosted by the Rockefeller Foundation called Project Terragua, which aims to develop and demonstrate the viability of a new model for African agricultural investment that can generate positive social and environmental return.

### **Innovative Financial Products for Social Investment**

Given the financial market crisis of 2008, investors may be highly wary of products that lack transparency. But clear products might present attractive options, such as creating a fund of

funds specifically designed to enable investors with large pocketbooks to try out impact investing while spreading their risk.

The objective of new products may be to aggregate a set of opportunities that make it easier for an investor to jump in on a social or environmental issue or set of issues they care about. As Jason Scott at EKO Asset Management Partners explains, “Bundle together enough product in areas that are similar or have similar risk-return criteria—such as microfinance, community development, and environmentally related assets—and that would really make a difference.” Blue Orchard’s Oasis Fund, which provides equity and loans to social and environmental ventures around the world, and responsAbility’s new bottom of the pyramid fund cross market sectors are examples.

### **Developing Infrastructure and Policy that Encourage Social Funding and Investment**

A thriving social enterprise industry requires the creation of a supporting ecosystem with common metrics, supporting tools, and investment-friendly policies and regulations.

A pervasive issue constraining a financial market for social enterprises is the absence of universally accepted performance metrics and measures. In addition, comparisons across different social enterprises have been difficult due to a lack of comprehensive publicly-available benchmarking data. The creation of a standardize set of performance metrics and benchmarking data would reduce financial transaction costs and bring much needed comparability data that is currently lacking in the social enterprise sector.

Secondly, the social enterprise sector lacks the tools and networks found in the private sector. Studies (Monitor Institute, 2009) have shown that a common set of risk assessment tools would benefit the efficiency with which capital is allocated to social enterprises. Additionally, sophisticated investor networks, which have worked so well in expanding venture capital investment, would benefit capital flows within the social enterprise sector.

Lastly, a sustainable social enterprise sector requires the support of investment-friendly policies and regulations. Regulations could align financial and tax incentives towards the social investment system, enabling social investment models that are replicable at scale. Examples of how regulatory support can enable the success of an emerging sector include community development finance and venture capital.

In this paper, three specific initiatives are addressed: Standardising social metrics, creative networks and ensuring investment-friendly social enterprise policy and regulation.

### **Standardised Social Metrics and Transparency in Measuring Social Impact**

For impact first investors, the most important priority is to develop rigorous metrics for assessing the relative social and environmental impact of investments and portfolios within and across the sectors and geographies that matter to them. This would allow them to assess the results from investments that may be below market rate. Understanding this

potential trade-off will be especially important to institutional investors. Developing comparative metrics will be challenging—it has long been one of the toughest nuts to crack in the social sector. Currently, there are several competing social impact metrics that are not easily comparable.

Hence, an additional step would be to establish a standard-setting body that would help create a threshold for what would be considered an impact investment. A basic rating system would help organize the market by making it possible to compare outcomes of investments. It would also help protect the credibility and reputation of the field from conventional investments being promoted as impact investments. As one foundation leader puts it, “To address the integrity constraint, certification has to set a floor instead of a ceiling as the industry can’t make the mistake of reaching too high.”

Effective action around either of these forms of initiative is most likely to come from capital providers who would need to coordinate to form standards for benchmarking jointly, informed by sell-side companies. At the same time, success of this initiative would require these investors to give up some level of specific interests that might otherwise necessitate total customization of reporting. Ultimately the movement of a critical mass of investors will be required for a standard to take hold.

There is much to be learned from the standards-setting activities in socially responsible investing, including the framework of the Global Reporting Initiative and Social Accountability International (SAI) standards (i.e. SA8000). Other industries provide helpful analogues. For example, financial first investors might be interested in a type of metric that communicates simply whether an investment is an impact investment at all without needing to dig into too much technical detail. The Forest Stewardship Council (FSC) provides third-party certification for timber with a single globally accepted standard. Similarly, the U.S. Green Building Council developed the Leadership in Energy and Environmental Design (LEED) standards as a nationally accepted benchmark, and acts as a third-party certification program. It has developed specific ratings (e.g., platinum, gold, silver) that are customized into versions for different types of buildings such as retail and schools. These standards are a powerful communication tool. Executives may not be experts in exactly what the FSC or LEED standards mean—but they know they want their wood and buildings to meet those standards.

A new effort called Project Galileo is working toward the goal of this initiative. The project is being pursued by a working group of the Global Impact Investing Network. Support for this work or the launch of competing approaches—whether through applying and testing metrics or providing start-up capital for a standards-setting body—will be required to create the analytic tools and infrastructure needed to place assessment of social and environmental value at the heart of an investment, rather than as its coincidental side effect. Acumen Fund is also working with Google, salesforce.com, and others to develop a data management solution that would enable customizable financial and impact data to be more easily compared across current or potential investments.

While the initiative is currently coming from the private sector, an important question is who should regulate and monitor the measurement standards. To be credible, some kind of

independent agency would be necessary. This agency could be state-led, civil-society based or private (if the concentration and interest-conflicts of rating agencies can be avoided).

### **Social Impact Investing Networks**

Today there are a number of national and even global networks playing important roles in specific arenas, such as the Emerging Markets Private Equity Association, Investor's Circle, the More for Mission Campaign, PRI Makers Network, Social Investment Forum, Social Venture Network, Societal, ClearlySo, and Phineo. However, there is no global network designed to serve impact investing as a whole with a focus on suppliers of capital and intermediaries.

Establishing global networks of impact investors would help address the inefficiencies caused by the isolation and fragmentation in today's market. It would provide a forum for investors to find partners and learn from their peers' experience and experimentation. A network would also accelerate the development and implementation of other initiatives by providing a space for coordination and collective action. For example, a network could serve as a locus for coordinating the development of metrics, launching a targeted public relations campaign, or even advocating for policy incentives for impact investing.

The network could be governed by a representative group of investors who would guide its activities to respond to the evolving needs of the investor community. The network membership could also serve as a source for information about barriers that could inform the development of new initiatives and help guide the efforts of leaders committed to building the field.

The early-stage development of a global network has already commenced; for example, emerging networks have resulted from talks held by the Rockefeller Foundation in 2007 and 2008. The group of investors is designing the Global Impact Investing Network to bring together impact investors and intermediaries who have the capacity to invest and intervene at scale, making multi-million dollar investments and aggregating funds large enough to access institutional capital. It will include both impact first and financial first investors and is intended to support activities that facilitate a more efficient yin-yang deal space.

### **Investment Friendly Regulations and Tax Policy**

Although typically an initiative like this could take a bit longer to come to fruition, the financial market crisis of 2008 has created a unique window of opportunity for policy change, potentially as part of a larger package of regulatory changes. In the United States, an anticipated jobs program—centred on green energy infrastructure and developed to entice private investment capital—is a particularly compelling early opportunity for impact investing policy. The UK government has launched the big society plan in 2010 and the Big Society Bank in 2011. Ultimately such a policy has the potential to transform both the economics—and the mind-set—about the value of impact investing.

In addition to providing regulatory support to social enterprise, government can address incentives through tax policy. One reason for the lack of funding for social businesses is the potentially high risk and moderate return they offer. However, if it is in the interest of society to support this sector for the social benefits that it offers then it is reasonable to create tax incentives to lower the barriers for its growth.

### **Enhancing Social Enterprise Capacity and Capabilities**

In addition to having the sources of funds and the infrastructure and regulation in place to efficiently allocate the funds, a thriving social enterprise marketplace requires the absorptive capacity through which funding is channelled. Social enterprises need to offer scale in order to be attractive to large pools of capital. Also, management expertise is a core requirement for many social investors. Finally assistance in finding and communicating opportunities exist to achieve all three (Monitor Social Investment Report, 2008).

### **Tools and Models for Scalable Enterprises**

Social enterprises have historically found it difficult to achieve scale. Many business models are constrained by various factors that inhibit achieving critical mass, including over-dependence on the founder or other key individuals, limited leverage of infrastructure investments, and difficulties in replicating key success factors. Innovation is key to creating the new models that will enable impact investing to generate returns while delivering social and environmental benefit. One way to foster innovation is to support entrepreneurs with research and development. For example, with microfinance, Grameen developed an innovative approach to lending. Other organizations then copied it, benefiting from the fact that somebody else had already paid for and conducted the research and development.

Innovations with replicability have the potential to be implemented and delivered broadly and therefore to create large impact. However, this very replicability may make it more challenging for the developers to capture the value of their model. For example, while the well-known Aravind Eye Hospital provides a highly effective model for serving poor patients in India, it has not been replicated, probably because, like many highly innovated approaches, the model is too hard and complicated to copy. This tension may create a disincentive for financial first investors—and highlights the need for new ways to share research and development costs and understand how value is distributed. As a result, impact first investors may have an especially important role to play in supporting this type of initiative.

### **Effective Management Capacity**

Despite recent advancements in attracting top management talent, social enterprises are still well behind their for-profit counterparts. The main cause behind this issue is the difficulty in



offering salaries competitive with the private sector. Additionally, various culture-specific factors impact the social enterprise talent pool; for example, in Anglo-American society, a perception exists that social enterprises are for semi-retired individuals. A workforce more willing to consider social enterprise options coupled with more effective management capability building initiatives will help bring the management gap.

Generally, the provision of technical assistance scales most effectively when integrated with capital investment. Increasingly, innovative private equity and debt funds are building assistance into their models, including organizations such as Small Enterprise Assistance Funds, Root Capital, and Grofin, who are scaling lending and investment into the hundreds of millions of dollars across Latin America, Africa, and Asia. Some funds, such as Acumen Fund (which works globally), will provide this support as a condition of investment. In other cases, assistance is treated as a service that portfolio organizations pay for (e.g., for Business Partners International, in South Africa). A different business model provides technical assistance to support growth without funding, as with such organizations as Technoserve, Ashoka (which also fund early stage social entrepreneurs), StartSocial, GSV and Endeavor.

While technical assistance may need to be fairly customized, funders can also improve their selection of viable opportunities and better support entrepreneurs by ensuring they have a stronger understanding of what archetypes of business models have the potential to scale. For example, understanding whether it makes sense to invest in a solar lantern plant for serving the very poor in developing countries depends upon understanding the ability of target customers to pay. This could be facilitated through shared research resources and collaboration with related private sector industries. In addition, many entrepreneurs would benefit from platforms that enabled them to link into existing supply chains.

### **Finding and Communicating Appropriate Financing Strategies for Social Business**

Governments and private actors could expand the information on alternative sources of finance for social enterprises and provide guidance on access to such sources. In addition, social enterprises and related networks could highlight successful examples of funding, and encourage other social enterprises to consider the range of available financial products.

### **Concluding Remarks**

The social enterprise sector has undergone a significant evolution over the past three decades, growing both in size and sophistication. In the recent past, the global economic crisis of 2008 has created a financial ripple that has impacted the sources of funding which social enterprises have come to rely on. Despite this disruption, the subsequent shifting of global financial and labour markets has created many opportunities for the social enterprise sector. The squeeze on traditional funding sources has meant that social enterprises need greater innovation in seeking and securing funding while also opening up new sources of

capital that has moved out of the mainstream sector. Also, the flood of talented labour from the private sector has benefited the social sector more than any other.

The focus of this paper has been to provide a background to the emerging social enterprise sector, and suggest initiatives to help the sector gain the sophistication and scale necessary to be self-sufficient. This paper is also intended to be read in conjunction with the Global Economic Symposium expert panel session entitled: “*Funding Social Enterprises: Out of the Ashes of the Economic Crisis?*”. A set of Global Economic Solutions will arise from the panel discussion and supplement the initiatives proposed in this paper. It is hoped that existing initiatives supplemented by Global Economic Solutions, will inform and encourage readers and conference attendees to take action towards developing the emerging social enterprise sector.

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