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Benevolent Schizophrenia - A Tale of Donors and Investors

Felix Oldenburg, Contributor

A Swiss hotel high in the Alps filled with wealthy philanthropists suffering from a peculiar affliction. What sounds like the setting for a mystery thriller is the scene for a revealing discussion about giving and investing.

There are two types of people in the room: grant makers and social investors. Grant makers feel anything other than giving without any financial return to an often highly specific cause is not what they want. With all the hype around impact investing, however, they wonder if losing their money is a little passé. Social investors, by contrast, see anything below inflation rate return as a failure. And why not get more buck for the bang?

The peculiar bit: The two groups of philanthropists overlap by about 80%. They are largely the same people, yet they give to projects they would never invest in, and invest in organizations they would never make a donation to. As if from different planets (more on this), their two strategies are completely disconnected. Benevolent schizophrenia.

After a while, the grant makers confess to a challenge: They would like to help their grantees become sustainable, but are not sure what that exactly means. After all, grantees mostly come back for more grants. Social investors share a different problem: They and their intermediaries have a hard time finding investees, because too many social entrepreneurs remain dependent on unreliable income sources and are unable to return funds with interest, or have strategies that may not benefit from investments (more on the dangerous promise of impact investments).

The discussion in the hotel is indicative of the state of philanthropy, which operates with instruments at the extreme ends of the return spectrum – -100% for grants, +x% for investments – and nothing in the middle.

What they should realize is that each philosophy is the key to solving the other's problem, and more importantly, some of societies' most urgent problems – IF they can me made to work together.

American psychologist Abraham Maslow observed: "I suppose it is tempting, if the only tool you have is a hammer, to treat everything as if it were a nail." Translated to philanthropy: When you are a grant maker, every project looks like a potential grantee, and every project will treat you as a grant maker. The same applies to the investor-investee relationship.

However, philanthropy has more than one tool. Maybe it is time to rehabilitate grants as a key tool in the investor toolbox. They are not a "loser currency" but can be the precursor or companion of investments, for example as investment readiness grants, as loan guarantees, even as equity without dividends. Applied to the same organization or field, smart grants can leverage investments many times over, as long as they do not carry pointless restrictions, and are part of a larger plan creating other unrestricted, long term sources of income.

Both grant makers and investors have to learn new tricks and use new tools for connected, hybrid strategies (see this HBR thinking on combining giving and investing). The encouraging news is that helping social entrepreneurs grow is not dissimilar to many other growth challenges of ideas that started without immediately profitable markets but high social value – the history of business is full of them.

Benevolent schizophrenia is curable. All it takes is to view social entrepreneurs with both eyes – as a continuum; an open pipeline of collaborative deals.

Hallucination or vision? What do you think?

Forbes
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Three Things Governments Should Do For Social Entrepreneurship

Felix Oldenburg, Contributor

Today, Europe's leaders are discussing a $1,000 bn budget framework for the EU, and for the first time, there are budget lines for social entrepreneurship – although you may have to find them with a very large magnifying glass.

Social entrepreneurship and government have long had more than an arm's length distance between them, and the feeling was mutual: the movement drew much initial energy from its bottom-up — and privately funded — approach that remains a contrast to many government-led efforts both in development aid and domestic social services.

Over the past decade, the relationship has been transformed. And if my own calendar is any indication, this transformation is reaching a tipping point in Europe. Within a few weeks, I am to attend meetings on a multi-year social entrepreneurship effort in Germany, a new social innovation strategy inFrance, and a new round of policies as part of the EU-wide Social BusinessInitiative.

And defying to the perception of the UK as the only key innovator for the social economy (no doubt in part due to the comparative advantage of the English language as the global transmitter of ideas, compared to French or German), continental Europe is emerging as an innovation space for the new role of government in social entrepreneurship.

Some examples: The German government-owned development bank KfW has launched the first public-private parallel investment program specifically for social entrepreneurs. It matches any repayable investment at any interest rate, in a gutsy move to mobilize Germany's startup investors. At the same time, the European Commission launched a whole set of ideas (some old, some refurbished, some new) as part of a Social Business Initiative, a uniquely comprehensive agenda regulating social investment funds, creating a new €90m fund of funds, and supporting financial intermediaries.

There is hardly a government not announcing funds for social entrepreneurs these days. Most of them, including the (justifiably) celebrated UK social impact bonds scheme, aim at bringing investment capital as well as the logic of capital markets to the nascent field.

This, however, will not be enough. Already, many funds, governmental or private, fail to find the investees they were intended for.

Supporting social entrepreneurship requires a holistic view of: 1.) where great ideas come from, 2.) who drives them, and 3.) how they grow, and each of these questions challenges governments to think outside of the box of providing investment capital.

1.) Filling the pipeline for later stage investments requires a robust identification and support mechanism for early stage social entrepreneurs, most of whom do not self-identify as such but are to be found in the most unlikely of places. The best mechanisms here are not governmental but philanthropic, but **governments can help drive a culture of recognizing and celebrating change-makers** not only in London and Brussels but in Transsylvania and Sicily.

2.) Social entrepreneurs are entrepreneurs, and entrepreneurs are rare. They are also typically not as naturally equipped or inclined to apply for government support as the managers in long-established welfare organizations. So**governments need to create regulation-free special social development zones** with no questions asked seed funding, tax exemptions and trouble-free borderless giving.

3.) Growing the best ideas across borders will be the true test for the EU internal market. Ireland has recently started importing, or "localizing" social innovations, and the troubled economies from Portugal to Greece should do the same. This would provide instant job creation, and would not require waiting for the next great idea to emerge from local changemakers.

And here is a final idea, one that could help the investment schemes above jumpstart a market. How about we copy the idea behind billion-Euro export credit insurance schemes that enable much of Europe's exports to help with the default risk of investments in social entrepreneurs? (Thanks to Norbert Kunz who had the same idea). With the risk lowered, investors would be able to fund more innovation and more early stage organizations. After all, fixing our societies' most urgent social problems sounds no less relevant than selling machinery.

Next week, a high level expert group of the European Commission will think about these and other ideas. Governments may be late to the party, but they may yet become very welcome guests.

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From Solar System to Ecosystem: A New Way to Finance Social Entrepreneurs

Felix Oldenburg, Contributor

Have you ever taken a planet walk? Along a hiking trail, you start with Mercury and Venus, about the size of golf balls, a few meters apart on pedestals. You walk past melon-sized Mars and Earth to a giant Jupiter, and so on. The realistic size differences are compelling. And the distances? Well, let us say you'd better prepare to reach Pluto.

For social entrepreneurs, finding capital is like taking a planet walk without water or a map, trying to adapt to the rules for each planet of the social finance solar system. Foundation Planet has no expectations for return but may be quite demanding in restricting spending to a specific purpose (including the purpose of making the foundation look great). Government Planet is super-sized but has a squashing gravitational field of administrative burdens and delays. Impact Investing Planet predicts it will grow massively but only works for a still-small target group of investees. And so forth for private donors, banks, venture capital, and other groups of funders.

There may be plenty to improve on for each of these funders, but the experiences of 3,000 Ashoka Fellows in 70 countries reveal that the main challenge is universal: Funders live worlds apart, in largely self-contained systems with their own ways of doing things.

This simple fact has massive consequences: Most social entrepreneurs face prohibitive fundraising costs, do not get the right funds at the right conditions, and hardly ever get funds when they can best use them to grow their innovations to scale.

Unless we turn the social finance solar system into an interconnected financial ecosystem, we are not going to solve the world's toughest problems at scale, despite the presence of growth-ready solutions driven by brilliant social entrepreneurs. Consider a few possibilities: Indonesian social entrepreneurTri Mumpuni could build

green micro-hydro power solutions in every community. Teach for All founder Wendy Kopp could recruit top university graduates to teach in tough schools in every city. Gynecologist Frank Hoffmann could prevent deaths from breast cancer with his blind tactile examiners. And Bart Weetjens' Hero Rats could de-mine former battlefields at scale for minimal costs.

Blaming social entrepreneurs or their lacking financial skills for the failure to secure growth funding is a popular but deeply cynical view on the side of social investors. The real failure is the lack of interconnection among investors.

The social finance system needs to learn two lessons: Every solar system has a center. That's where the social entrepreneur should be. We should turn the tables, and have fund-pitching rather than fundraising conversations. And every funder should think about making the smartest possible deal, leveraging different risk and return expectations of other funders.

This is not revolutionary thinking. Earlier this year, HBR pointed to the huge untapped potential of combining philanthropic with investment capital. And most success stories of innovations in fact are stories of investors working hand in hand (although rarely by design). A Monitor report a few weeks ago revealed that the microcredit sector required $20 billion in development fundsbefore it became self-sustaining.

We are present at the creation of a much smarter financial ecosystem. Social impact bonds may be hyped but are a great illustration of the kind of interplanetary alliances we need to see more of.

What's next? Foundations could create guarantee funds that enable a new wave of social investments, banks could provide working capital with philanthropic backing, local governments could issue Human Capital Performance Bonds … This is a time for collaborative entrepreneurship.

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What Is The Next Banking Crisis? (Hint: It Cannot Be Solved With Money)

Felix Oldenburg, Contributor

Rattled by the housing debt breakdown, collapsing money markets, recessions, and the lingering Euro crisis, bank CEOs have had plenty to lose sleep over in recent years. Yet (most of) their banks will survive. The question is: Which will emerge stronger?

A bank needs more than a functioning money supply to thrive. It also needs a supply of bright minds. Many people may follow the money, but most money actually follows the best talent.

A new reason to worry for bankers embarking on the milk round on university campuses soon, then, is the fact that most of the brightest graduates no longer name banking among their top career choices. If persistent, this trend amounts to a catastrophe for an industry that holds its most valuable assets neither in gold vaults nor in brand value, but in brainpower. Why choose banks over other career destinations? This question may require a much deeper rethinking of banking than even the past years of constant crisis. And the banks that find the best answer will win.

This seems to be a challenge that cannot be solved by throwing money at it. Compensation and bonuses are as attractive as ever. The jobs themselves have also not changed much. What have changed are the expectations of the recruitment targets.

While previous cohorts have been attracted to the banks through the ticket to VIP life, today's generation asks new questions about the impact on society. The dream used to be to exit early, burnt out but rich. Now it is more about flextime and work life balance. Today's graduates want to work in places that will give them a positive sense of identity and meaning. In other words, for most graduates: not in today's banks.

The sleepless CEOs should perhaps consider as bedtime reading a history of the finance sector, and they would find that banks have been about much more than we realize today. Finance can be about enabling more people to do more with their lives – to turn entrepreneurial talent and creativity into businesses, to drive economic opportunity in unlikely places, and to insure against poverty. The history of finance is also a history of inclusion and economic empowerment, and many of its success stories started as social innovations: from cooperative banks for farmers to community banks for the urban poor, all the way to microcredit for the bottom billion today. Social niches have often enough become viable markets.

It is no different today. The rise of ethical banks and impact investing in wealthy economies – but more importantly the growth of mobile banking and online lending networks – point to opportunities for today's banks to do well by doing good.

However, the massive growth projected for these innovations so far takes place outside the formal banking sector, in informal, unregulated networks and outside of the banking system.

This, then, is the challenge: To attract the best and the brightest to help half of the world's population gain access to credit, to send the $150 billion of unsecured remittances through secure channels, and to find ways to finance some of the world's great new ideas in the most unlikely places.

Banks can do it. They have done it before. If they rediscover their historical mission to lift people out of poverty and create economic opportunity, they will deserve the best talent.

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Define Social Entrepreneurs by Their Impact, Not Their Income Strategy

Felix Oldenburg, Contributor

After decades of frustrating setbacks, scientists at CERN think they have found the Higgs boson particle — a breakthrough success after $12 billion of research funding and smashing particles into each other in all imaginable ways. A few days ago, my colleague Amy Clark argued that there is a lesson about collaboration to be learned. I will use this discovery to argue that there is also an important insight for funders of social innovation.

The CERN research shows us that definitions are never more than hypotheses until an innovator thinks outside of the box. This is also the case in the field of social innovation, where experts and academics have struggled to define "social entrepreneurship" ever since the term was coined 30 years ago. Just like scientific research, social innovation often defies funders' rigid definitions and expectations.

Many of the funders who have entered the burgeoning field of social entrepreneurship in recent years come from a background of commercial finance, and naturally they favor definitions focusing on the social ventures' ability to repay investments. Some have gone so far as to suggest we can only fund the solutions to the world's toughest social problems if we go leave philanthropy behind and tap into fantastic sums of capital ($500 billion, according to a Monitor study) by making profitable investment propositions.

This promise itself has a dual impact. It is great news for many social entrepreneurs who are asking themselves new questions about monetizing their impact. But it also silently shifts the definition of social entrepreneurship for everybody – with unintended and unfortunate consequences.

First, the analogy of business and social entrepreneurship is useful but incomplete. It does not take into account that money and value flow differently in the citizen sector. What is earned income, anyway? In the citizen sector, grants and donations are often a form of market payment by a third party who steps in when beneficiaries cannot pay or when the benefit is too widely distributed to be "monetized." (David

Bornstein recently made a brilliant point about the confusion of investing in vs. buying from social entrepreneurs). The key question is not about the source of funding streams, but about their reliability. Social entrepreneurs who succeed in combining income from beneficiaries with steady supporter donations and grants from a healthy mix of foundations can be at least as stable as any purely customer-based social business.

Second, it is a dangerous promise for some social entrepreneurs (as I have argued elsewhere). Dangerous, because it may force them to abandon lower-revenue strategies that may lead to higher impact, and dangerous, because it locks out social entrepreneurs working on particularly tough problems with very early markets that are years or decades away from generating returns.

Microcredit, a poster child for self-sustaining social business, required $12 billion (about the same as the CERN researchers) in grant funding before it built its market, according to Monitor. In fact, many of today's breakthrough successes of social entrepreneurs do not follow the business school earned-income blueprint, but use mixed income sources instead. Many of them also use open growth instead of value-capturing organizational growth, as the global scaling strategies of Ashoka Fellows in the Globalizer program clearly show.

The lesson investors could learn is this: Insisting on earned income early on can reduce the chances of funding the best solution available. Therefore, using self-financing as a definition for social entrepreneurship is a distraction. If we need definitions, let us use those that do not restrict the opportunity space, but open it up.

Recently, my six-year-old godson asked what I do for a living. I paused and thought through the myriad of definitions of social entrepreneurship in my head, and decided against all of them. "Do you know someone in your class who you trust will achieve anything they set out to do, someone who always finds the solutions?" I asked. "Hm. Yes," he responded after a while. "Okay, now imagine that person has as only one goal: to build a new solution for a problem we have in our society … That is the person I want to find and give money to do just that."

I like the analogy that social entrepreneurs are the research and development arm of our societies. If we take it seriously and keep an open mind with regards to income strategies, and leverage all the different funders living on their different planets, there could be more breakthrough successes in the citizen sector on par with the historic discovery made in Geneva.

The New York Times
Opinionator

JUNE 27, 2012, 7:30 AM

For Ambitious Nonprofits, Capital to Grow

By DAVID BORNSTEIN

Imagine that you're an entrepreneur running a chain of coffee bars and you want to raise capital to open up in new locations. You meet a potential investor, and he says, "I'd love to finance your business, but only the chai latte operation, not the coffee, and only to support drinks you sell in Cleveland next year."

It might sound absurd, but this is the kind of thing that people running nonprofit organizations hear all the time. Whether they are providing housing or preschool or vocational training services, social organizations typically find their funding restricted to specific programs, locations and time frames. That doesn't make it easy to grow.

That's why even the best social organizations grow slowly compared with companies. As a result, very few nonprofits ever go national - and those that do take the better part of a century to get there.

While things are improving for nonprofits in this regard, the situation is nowhere near as efficient as it is in the business sector, where successful companies like FedEx, Home Depot or Google can raise the money they need to build national or global operations in a decade or two.

What if great social organizations could grow the way companies do? Could we solve our social problems more effectively if we improved the way we finance them? There are actually many modest-sized organizations that get impressive results, doing things like boosting academic achievement, preparing unemployed clients for good jobs, getting homeless people into supportive housing. If they were businesses, they would attract investment. As nonprofits, however, they are like Ferraris on a dirt track. What if we could figure out how to help high-performing organizations get on the highway? Could success become more the rule and less the exception?

One organization that is exploring this question is the Nonprofit Finance Fund (N.F.F.) Capital Partners division, which has developed a creative model for helping successful nonprofits raise what it calls "philanthropic equity" - grants that mimic the institution-building function of for-profit equity. N.F.F. Capital Partners reports that, since 2006, it has advised 18 organizations that have raised $326 million in

donations to finance growth, and in turn, those organizations have markedly increased their impact.

N.F.F. Capital Partners was established in 2006 by George Overholser, a former venture capitalist and strategy consultant who saw an unmet financial need in the social sector. The year before, Overholser had helped College Summit, a highly regarded program that helps disadvantaged youth enroll in college, prepare for a growth leap. The organization's founder, J.B. Schramm, wanted to try to raise college enrollment rates across whole schools and districts in low-income communities rather than student by student. Overholser saw that the organization couldn't do it by cobbling together a bunch of short-term grants. Businesses don't raise capital that way. If College Summit were a business, it would formulate a growth plan, go out and raise equity, and execute the plan. They decided to try it out.

Nonprofits can't raise real equity because they don't have owners. The question was: Could College Summit convince funders to provide large multiyear grants *as if* they were investing in a for-profit - and would it change things? "There is a fundamental difference between equity and revenue," explains Overholser, who recently co-founded a new firm called Third Sector Capital Partners. "The role of equity is to pay the bills while something learns to fend for itself." Equity pays for mistakes and unanticipated problems - hiring the wrong people, expanding to the wrong locations - as managers figure out how to operate at an enhanced scale on a continuing basis.

Equity isn't money you live on; it's episodic. Corporate chiefs may embark on fund-raising rounds for a few months every number of years. This stands in contrast to nonprofit C.E.O.'s, who are continually on a fund-raising treadmill. Philanthropic equity is aimed at *building* an enterprise. By contrast, grants or fees usually *buy* services for needy beneficiaries - housing, tutoring, foster care, health services and so forth.

Simply put, builders and buyers think differently. "If you *invest* in Starbucks, what you care about is Starbucks being healthy over time and lots of people buying the coffee and, in fact, you want the coffee to be high priced," explains Craig Reigel, current managing director of N.F.F. Capital Partners "But if you *buy* from Starbucks, you care about getting the best cup of coffee for the lowest price. The way you think about success is completely different."

Many large foundations approach their work as builders, of course. But most are buyers. And the biggest funder of all - government - is decidedly a buyer. What would happen if everyone in the nonprofit sector paid more attention to the differences between *build* and *buy* money like everyone does in business? Would it help more organizations grow to their potential?

College Summit developed a four-year growth plan that required $15 million in equity (its budget was $9 million at the time). The organization's board chair, Charles Harris,

a recently retired executive from Goldman Sachs who is now director of capital aggregation at the Edna McConnell Clark Foundation (which has a major growth financing initiative of its own), suggested that they raise the money the way a company would seek a "private placement" of capital. "We held a series of roadshow meetings with finance executives to share the opportunity and seek their support," recalled Harris. "This was not about designing a program on the basis of funder wishes." They raised the money in nine months.

What amazed Schramm was that it was possible to raise money against a plan and that all the investors signed on to the *same* goals and reporting requirements - a social entrepreneur's dream. Over the course of the four years, College Summit built expertise, trained staff around the country, identified new partners, developed new measurement tools and grew from serving 3,600 students to 17,000 per year. It now has a more efficient model and serves about 50,000 students in 175 schools. The challenge, as always, is maintaining itself at this level or, perhaps, scaling up again.

After 2006, Overholser and his partner Reigel developed a standard approach to help others. "We showed them how to set up a process to track and report how things are going, an accounting system to keep the equity and revenues separate, and tools so that everybody - donors, management, the board - can be on the same page and see how it all works," explained Reigel.

One of their clients, VolunteerMatch, which helps Americans find volunteer opportunities online, raised $4.2 million in equity to upgrade its Web platform and fee-based services. Since 2007, the organization has doubled its impact, facilitating more than 620,000 volunteer connections in 2011. "If we had tried to go a traditional philanthropic route, it wouldn't have happened," explained Greg Baldwin, the organization's president. "You can't build an operation and scale it if you're trying to package 15 different programmatic grants that all have different goals based on the priorities of 15 different foundations." The growth plan got everyone aligned.

Year Up, an organization I've written about in Fixes that provides vocational training to disadvantaged youth, also worked with N.F.F. Capital Partners to develop a "prospectus" that enabled it to raise $20 million in growth capital and triple its reach within four years. Year Up supports itself mainly through a combination of philanthropy and fees from companies.

Another web-based organization that made a leap after raising a round of growth funding is DonorsChoose.org, which brokers connections between citizen philanthropists and classroom teachers. In 2006, DonorsChoose.org was generating $2.6 million worth of funding for teachers' projects. In 2007, it raised $14 million in equity-like funding from the Omidyar Network and several other investors and used the money to improve its technology platform, expand nationally and strengthen its revenue generation. By 2011, the organization was covering its $6 million operating

costs with user fees and generating close to $26 million worth of funding for classroom projects, a ten-fold increase in five years.

Whether an organization grows depends on factors beyond capital - including opportunity, need and, above all, entrepreneurial leadership. Most nonprofits, like most businesses, will never grow large. But the ones that have the potential to achieve major impact shouldn't be stunted by a fragmented grant-making system.

That said, there are risks to seeking equity-like financing. At College Summit, Schramm and his colleagues found themselves under pressure to quickly assemble the right team to mobilize local and national philanthropy and bring in fees from schools to maintain a higher level of operations. "The danger with growth capital is that the organization grows dependent on it," says Schramm. "If the operation isn't covering its ongoing costs, you can build up a huge deficit that's invisible until the money runs out. Then you fall over a revenue cliff."

Philanthropic equity will likely become more important in coming years. As Tina Rosenberg reported in Fixes last week, with tools like social impact bonds, social investors and governments are focusing more on measurable outcomes. Social organizations are going to have to respond. "Social impact bonds will create another form of 'buy' money," notes Antony Bugg-Levine, chief executive of the Nonprofit Finance Fund. "But many nonprofits are not prepared to succeed in a world that's based on governments paying for outcomes. They'll have to transform themselves - and that will require more 'build' money so they can invest in better systems."

The changes are already underway. As governments cut back on the fees they're paying nonprofits, many groups are faced with overhauling their systems to run more efficiently. These institutional changes also require equity-like financing. In fact, Bugg-Levine calls philanthropic equity "*change* capital" rather than "growth capital." Change is afoot.

"Nonprofits aren't just useful, they're valuable," notes Craig Reigel. "That means one can and should invest in them - and that's different than buying things from them."

David Bornstein is the author of "How to Change the World," which has been published in 20 languages, and "The Price of a Dream: The Story of the Grameen Bank," and is co-author of "Social Entrepreneurship: What Everyone Needs to Know." He is the founder of dowser.org, a media site that reports on social innovation.

theguardian

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Financing social entrepreneurs

How social entrepreneurs can work with corporate organisations to create new ways of raising finance

by Mark Cheng

When social entrepreneur Luke Dowdney needed to raise funds two years ago to support Fight for Peace, the charity he founded that teaches boxing and martial arts to at-risk youth to reduce violence in gang-ridden communities, he didn't go the usual route of looking for donations. Instead he launched LUTA, a martial arts-based sportswear company featuring street wear created by young designers from the tough Brazilian neighbourhoods where Fight for Peace began.
In doing so, Dowdney raised just under £1m in investment from seasoned investors who loved the idea. Half of the profits from LUTA go to support the charity, providing much needed funds at a time when other charities were seeing donations dry up during the financial crisis. And the business provides street cred and useful publicity for the charity.

Dowdney's solution is typical of the kind of creative business and financial innovation that social entrepreneurs are increasingly adopting to stay afloat, and indeed to thrive.

Social entrepreneurs often struggle with the dilemma of how to raise finance. Should they be a charity, and seek donations? Or a business and look for commercial funding? They are driven by a social mission, but traditional philanthropy doesn't provide them with a stable, long term source of finance. At the same time, commercial investors neither understand nor trust them, many believing that "social" means "soft" and is usually a polite word for "loss-making.
So the fledgling social enterprise looking for capital to grow can find itself falling between charitable and commercial funding, and appealing to neither. Our current financial system simply isn't designed to meet the needs of these hybrid organisations that are businesses serving a social mission. Donors are used to giving grants to charities. They're not comfortable with making investments in businesses. And commercial funders – the myriad army of venture capitalists and angel investors – rarely offer the kinds of financing terms that most social enterprises can meet.

In response to this dilemma, social entrepreneurs are starting to do what they do best – they invent their own solutions. Take Faisel Rahman, for example. Faisel is the founder and CEO of Fair Finance (and regular Guardian columnist on social deprivation), a social enterprise which provides affordable personal loans and debt advice to individuals in London who would otherwise be wholly excluded from the mainstream banking system.
Four years ago, Fair Finance was caught in the dilemma described above – it had started life funded entirely through local authority grants and contracts, but now both were being cut. Fair Finance needed to access a different source of funding to grow, but the organisation wasn't set up to raise equity and, although financially sustainable, couldn't offer the kind of financial returns most venture capitalists would be looking for anyway.

What did Fair Finance do? It raised funds through its own bespoke financial instrument, one tailored exactly to the needs of the business. Fair Finance raised a loan offering a modest, single digit rate of interest and a flexible repayment profile which is based on a percentage of the profits produced by the business over the next seven years. If the business does well, the loan will repay quicker. If the business experiences a slow-down, the loan takes longer to repay, but cannot default.

With the support of organisations such as Ashoka, Fair Finance was then able to find socially-minded investors to back such an instrument, raising over £1m. The funding enabled Fair Finance to then secure additional bank lines, and has meant that it can now access many times more capital than could previously have been raised through grants alone, helping it achieve sustainability and begin expanding across London. Social financial instruments like this are just the start. New institutions and funders are starting to come forward to meet this emerging market of socially mission driven businesses. Many come from the world of philanthropy, with a new generation of philanthropists seeking to provide new "impact investment" instruments to complement the traditional world of grant-making. The Big Issue has launched a social investment fund to meet this need, organisations such as CAF Venturesome and SharedImpact have also been pioneering new financing instruments like the one used by Fair Finance. And new forms of fundraising, such as crowdfunding, where social enterprises can aggregate donations and micro-investments from large numbers of supporters via online platforms such as Kiva, Kickstarter and BuzzBnk, are also springing up daily.

More is needed. Here, corporate organisations with deep pools of financial and business expertise such as law firms, banks and consultancies can play an invaluable role, utilising their skills to help social entrepreneurs like Dowdney and

Rahman develop new sustainable business models to support their social mission, and then find the funding to support those business lines.

Recognising this, three years ago Ashoka teamed up with leading law firm Hogan Lovells to set up a social finance programme to create more of the tailored financing solutions that these organisations need. Other forward-thinking organisations are similarly engaged, for example strategy consulting firm Deloitte has launched Social Innovation Pioneers, under which its consultants provide pro bono strategic advice to 50 social ventures. Accenture runs Accenture Development Partners, which works with social sector organisations to come up with sustainable business solutions for development drawing on the best practices of both corporates and charities.

This isn't corporate social responsibility. It's corporate organisations doing what they do best – using their skills and resources to create new revenue and financing models – in partnership with leading charities and social entrepreneurs to jointly tackle social problems. Speak to the professionals at Hogan Lovells, Accenture and Deloitte, and they will tell you how much this means to them. This goes beyond charity - it's a unique and exciting opportunity to reinvent the entire way a sector works, and come up with badly needed new ideas to help the social enterprise sector become financially sustainable.

And for me, what's most exciting is the sense that we're only just getting started. How much more could be done once we unleash the creativity of the best minds in the corporate world to work on these issues?

Mark Cheng is the UK Director of Ashoka and the founder and executive director of Chelwood Capital

Thursday, May 26, 2011

The Dangerous Promise of Impact Investing

By Nilima Achwal

In my last conversation with Felix Oldenburg, Ashoka's Europe and Germany director, described his thoughts on the quickest, most powerful ways to unleash social impact across the globe. In part two of our conversation, in the days leading up to SOCAP Europe, Oldenburg took on - and took apart - what's being touted as a new industry: impact investing.

"Leading social entrepreneurs are people who are single-mindedly passionate about solving a social problem, but how they get there is influenced by the funding available," he began. "So funders have a great responsibility." However, he continued, the promise of channeling vast funds to social causes through impact investing actually does more damage than good. Oldenburg went on to craft a **radical critique of the current hype surrounding impact investing.**

First of all, impact investors need their investees to repay debt or equity, which requires a business model that can create profit surpluses. Many assume that the impact investing craze coincides with a strategy shift toward the social business model over the nonprofit model, as social entrepreneurs adjust to the demands of the funding marketplace. This, Oldenburg argues, is a myth. In fact, he finds that entrepreneurs are not moving toward models that create surpluses and believes they should not. "Great social entrepreneurs look for the fastest way to change the system with the cheapest form of funding available - not for the safest way to produce surpluses to pay back expensive loans or mezzanine capital." **This exposes the weakness of the impact investing movement, which is predicated on the ability, and willingness, of social ventures to generate income.**

NextBillion.net: Why do we have an impact investing trend if we don't have an increased income trend?

Oldenburg: Quite frankly, impact investors are sitting at the end of an oil pipeline, waiting for the riches to gush out, but they are finding few deals. The most common complaint from impact investors is the low deal flow in their industry, since there are so few social enterprises that meet their (often narrow) requirements for investment.

Some investors invest anyway, producing not only failing deals but also damaging the investees with their stringent requirements. The clever investors walk upstream to find the deals, and invest with grants and advice only to the organizations that will actually benefit from developing a "customer-based business model." (See Mark Cheng's bio.)

NextBillion.net: Then what types of social enterprises will benefit from impact investing?

Oldenburg: **Impact investing only works for investees that have an earned income strategy that is beneficial for social impact.** For simple product businesses, like selling cookstoves in Africa, there is a clear impact rationale to having an earned income strategy. Though these businesses are important, they rarely pave the way to innovation. They are not the high-end social entrepreneurs pioneering solutions where there may be no clear income streams - or where markets could take years to build. If you force impact investments on these solutions, you risk dumbing down their strategies from creating new market mechanisms to using existing ones.

The tragedy is that there is a psychological power differential between social entrepreneurs and social investors, so the former will spend a lot of time and make a lot of mistakes accommodating the latter before they understand whether or not an earned income strategy is, indeed, the fastest way to impact. Many social entrepreneurs are stuck in a fundraising mentality. They listen to the impact investors, who often impose hefty terms like two-digit interest and an equity stake with veto power-expectations that are simply not conducive to expanding social impact. They get even deeper into fundraising trap by focusing everything they have on generating revenues. And the impact investing hype also makes social entrepreneurs think that this is what the funding marketplace expects, shifting many organizations to strategies that limit their impact.

NextBillion.net: What do we need to do, then?

Oldenburg: We need to think differently as supporters and funders of social entrepreneurs. We need to refocus on a paradigm of funding that starts from the impact and not the return.

First of all, we need to ask, does it make sense for a social entrepreneur to pursue a direct earned income strategy? If we take a hard look at the fastest growing ideas, we realize that the most powerful strategies that disproportionately grow social impact in comparison to the organization - empowering employees and other organizations, open-sourcing, building hybrid value chains, and creating a movement

around an idea instead of a slow-growing monopoly-do not lend themselves well to impact investing. The future of innovation in the social sector is not limited to individual businesses that generate profits – it has to do with collaboration, partnerships, and empowering others to help you.

Many impact investors come from traditional finance, so perhaps they assume that social entrepreneurs, like business entrepreneurs, want to capture as much value as possible within their organization. The opposite is true: Great social entrepreneurs want to create as much value as possible in the whole system, even if that means leaving revenue opportunities on the table.
Impact investing, in the worst case, will ***limit*** the very potential of an idea, by preventing strategies that could unleash social impact across the word. By forcing a socially impactful organization to focus on earned income, you will cage them.

On the other hand, impact investing could thrive if it manages to channel more funds toward proven and organically growing social enterprises, without luring systems-oriented social entrepreneurs toward incremental growth models.
Regardless, the fundamental shift in thinking remains - ***we must fund the impact, not the organization -*** and quickly, since there are thousands of social entrepreneurs waiting for the capital needed to unleash their social impact.
NextBillion.net: How can we fix this market failure?
Oldenburg: Monitor states that impact investing market could be as big as $500 billion in the next decade, double the amount of philanthropy given in the US in 2009. However, there are very, very few high-impact social entrepreneurs that would be able to use it. In other words, the demand for investable social entrepreneurs is much higher than the supply of capital; it's an entrepreneur's market.
The best social entrepreneurs will align themselves with trend-setting donors who will not primarily require an organization to grow and become stronger itself. Rather, they will allow an organization to let loose its social impact. These funders will realize that **an organization may fumble, but it is a tragedy if the idea dies with it.** They will know that if you start a movement with unstoppable impact, it doesn't matter what happens to the organization.

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Oldenburg is the first to admit that he does not know the solution, but we brainstormed: What if there was fund that provided incentives for an organization to spread impact, and did so by quantifying its impact (for example, by measuring the number of organizations that adopted its model)? And then, after the organization

achieved its impact, what if the fund reclaimed its investment, not from the investee, but from the institutions (government, etc.) that would otherwise have spent money on fixing the problem? The UK's Social Impact Bond is one experiment, but there are endless ways to engineer a new funding mechanism that supports impact growth over organizational growth. And the social capital marketplace is more than ready.