
Global Agenda Council on Social Innovation

Final Report

The Global Agenda Council on Social Innovation is concerned with building enabling environments that foster, support, and scale worthwhile social innovations. This year the Council focused on the growth of “impact investing” with the overriding objective of aligning the impact investment and social enterprise communities around expectations, capabilities, and returns.

The multiplication of impact investors is an important milestone for the sector and represents an important source of growth capital for social ventures. By some estimates nearly 200 impact investment funds are now registered and many foundations, networks, and mainstream financial institutions are becoming more active in this space. JP Morgan drew further attention to impact investing by declaring it as a “new asset class” in November 2010. But the growing excitement – some say “hype” – around the overall market potential and the higher return expectations of some newer entrants raises a number of questions about how it can effectively serve the purpose of supporting and scaling social innovations while not diluting their social impact.

The members of the Global Agenda Council on Social Innovation are leading academics in the field of social entrepreneurship, pioneers in impact investing with a decade or more of experience, and globally recognized social entrepreneurs who have built social ventures from scratch. The concerns and themes that have emerged from Council discussions to date are not based on hard data but are drawn from years of personal experience and professional expertise. The central themes and principles emerging out of the Council discussions are outlined below.

Emerging Issues and Trends

- 1. The projections being presented raise expectations beyond what the sector can currently deliver.** While there is consensus among the Council that the long-term potential of the impact investment market is enormous, Council members expressed concern about recent reports by mainstream financial and philanthropic institutions citing profits in the hundreds of billions over the next 10 years. While such studies do raise awareness about the sector, overly optimistic analyses may ultimately prove damaging if the hype inflates expectations beyond what the sector can realistically deliver in the near term. Council members believe now is an opportune moment to inject some reality into the current debate about the return expectations of investors and the absorptive capacity of social enterprises.
- 2. Despite the current focus on generating returns, the crucial role of subsidized capital cannot be underestimated.** Council members generally agreed that below-market capital will play a dominant role in building the capacity and industry infrastructure for years to come, emphasizing the formative role of government subsidies and philanthropic grants in providing the necessary start-up capital – often over several years – required to get social ventures to the point where they become attractive to commercial investors. A high-profile case in point is the IPO of Compartamos in Mexico, the success of which “is partly thanks to the non-profit capital that had been flowing in for years before commercial capital came in,” as one Council member said. Council members stressed the importance of disseminating cases to illustrate how different types of capital along the risk-return spectrum work with each other over time to collectively create results beyond what any single intervention could have achieved.
- 3. Local knowledge remains the “x” factor.** By definition, social ventures work with marginalized populations and in difficult business conditions. Council members who represent impact investment funds agreed that trust and respect are key to managing investments in their portfolio, likening the investor-investee relationship to one of dancing partners. Moreover, they assigned far

more importance to local knowledge than they originally assumed would be the case, because they view their role as much more hands-on than simply providing capital. “As an investor, only 20% of what you bring to the table is money,” said one Council member. “The other 80% is everything else. These are the hardest environments in the world to work in. The only certainty is that there will be trouble. How you help [your investees when they are] in dire straits is the key.”

4. **Anecdotal evidence indicates the industry is neglecting its future pipeline – young social enterprises that need smaller amounts of growth capital.** Some Council members voiced concern that the management fee structure of many impact investment funds is forcing the industry to consolidate towards larger deals. “Investments of \$200,000 or \$500,000 take the same time to manage as \$4 million investments,” explained one member, and others shared similar anecdotes about fund managers raising the size of their minimum investment deal to \$2 million. Should this anecdotal evidence indeed indicate a trend, and should this trend continue, this begs a serious question about who will be willing to provide transitional funding in the \$200,000 - \$2 million range, when a social venture has graduated beyond the \$100,000 or \$200,000 grant range but isn’t yet ready to take on a multi-million dollar investment.
5. **The closer social ventures get to capital markets, the higher the risk of mission drift.** Council members discussed the trade-offs for social ventures as they transition away from dealing exclusively with the philanthropic world of grants and move into the realm of investment capital to scale their model. “Once [social enterprises] start scaling, they more or less have two choices: governments or capital markets,” said one Council member. “If they choose the former, there’s a whole host of issues that comes along with that. But if they choose capital markets, then they lose the social impact. Not all of it, but they’re not really serving the poorest people anymore. They’re forced to go up-market.” Here again, Council members suggested profiling cases to elucidate the kinds of difficult choices and trade-offs social enterprises face as they scale their model.
6. **Different types of investments alter the risk profile of an organization’s capital structure – and may dampen the management’s risk appetite.** This creates a bit of a dilemma for impact investors. Risk capital typically takes the form of equity investment, but exiting from an equity investment in a social venture can be difficult, particularly if the venture is in a developing economy. The common exits of an initial public offering, an acquisition, or a stock buy-back all pose challenges, particularly if the social mission of the venture is to be maintained. Innovators are working on solutions to these challenges, but these are not yet well enough developed to provide robust exit (liquidity) paths for equity investors in social ventures. While debt is easier to provide when you need to be certain of a return, it can dampen the risk appetite of management.

The members of the Global Agenda Council on Social Innovation held a meeting in New York City in March to launch the Spring 2011 discussion series to explore these themes at World Economic Forum events. Sessions included private meetings at the Latin America summit in April, a public session called “Impact Investing: Balancing the Bottom Line” at the Africa summit in May, and the Workstudio session “Building Ecosystems for Social Innovation” at the Europe summit in June. The Schwab Foundation for Social Entrepreneurship is also soliciting feedback on these themes from its global community of leading social entrepreneurs.

In the coming term, the Council aims to build on these themes with robust case studies, develop policy recommendations and suggestions for further research, and collaborate closely with relevant industry groups and communities of the World Economic Forum to ensure that impact investing really does enhance the impact of the social innovations it supports.