CAIA GERMANY SOCIAL BUSINESS SYMPOSIUM 2013

Frankfurt
13 June 2013

CAIA SOCIAL BUSINESS SYMPOSIUM 2013

AGENDA

12:00 - 12:30	**Registration**
12:30 - 12:40	**Welcoming words:** **Laura Merlini**, CAIA, Director Business Development, Chartered Alternative Investment Analyst Association **Robert Koller**, CAIA, German chapter Co-Chair, Partner Simmons & Simmons
12:40 - 13:10	**Introduction to Social Business:** **Saskia Bruysten**, CEO and Co-Founder Yunus Social Business (Frankfurt)
13:10 - 14:10	**Panel: Social Impact Bonds** **Geoff Burnand**, Co-Founder and CEO, Investing For Good (London) **Jane Newman**, Director, Social Finance UK (London) **Dr. Keyvan Rastegar**, Attorney, Partner (Vienna, New York) *Moderator*: **Robert Koller**, CAIA, German Chapter Co Chair, Partner Simmons & Simmons
14:10 - 14:40	**Legal framework for Social Entrepreneurs:** **Katarina Melichercikova**, Policy Officer, European Commission (Brussels)
14:40 - 15:00	**Social Impact Investment and its Challenges:** **Marlene Carvajal**, Vice President, DEG - Deutsche Investitions- und Entwicklungsgesellschaft mbH (Cologne)
15:00 - 15:30	**Coffee break and networking opportunities**
15:30 - 16:30	**Panel: Investors in and facilitators of social businesses** **Dr. Markus Freiburg**, Entrepreneur in Residence, Ashoka, Finanzierungsagentur für Social Entrepreneurship (Munich) **Ingo Weber**, European Liaison, Global Impact Investing Network (Switzerland) **Edda Schröder**, CEO, Invest in Visions (Frankfurt) **Seb Elsworth**, Director of Partnerships and Communications, The SIB Group (London) *Moderator*: **Marlene Carvajal**, Vice President, DEG - Deutsche Investitions- und Entwicklungsgesellschaft mbH
16:30 - 16:50	**The Global Ecosystem of Social Business:** **Jane Newman**, Director, Social Finance UK (London)
16:50 - 17:50	**Panel: Social Entrepreneurs speak about their experiences** **Dr. Maximilian Horster**, Managing Partner, South Pole Climate Neutral Investments (Zurich) **Malte Höpfner**, Social Entrepreneur and Project Developer, University of Lüneburg (Berlin) **Dr. Maximilian Martin**, Global Managing Director, Impact Economy SA (Lausanne, Special Comment: Mainstreaming social business through impact investing) *Moderator*: **Constanze Döring**, Senior Associate, Simmons & Simmons
17:50 - 18:00	**Closing remarks**
18:00 - 20:00	**Dinner Buffet and networking opportunities**

PARTICIPANTS

SASKIA BRUYSTEN, Co-founder & CEO

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Saskia is Co-founder and CEO of Yunus Social Business GmbH (YSB), founded by Peace Nobel Laureate Prof. Yunus. YSB has the goal to help create social businesses. YSB sets up incubator funds and provides training, advisory and implementation services for companies, governments and foundations. It operates as a social business itself. YSB is based in Frankfurt with subsidiaries in Haiti and Albania and currently expanding into Tunisia, Togo and Brazil. Prior to that she was Co-CEO of Grameen Creative Lab and started her career at the Boston Consulting Group in their Munich and New York offices.

Saskia and her team have helped set up social businesses with major corporations such as Adidas, BASF, SAP and Crédit Agricole. Her team has pioneered the use of social business incubator funds in Haiti ($5M), Albania (EUR10M) and Mumbai ($1M) and is launching new funds in Brazil, Tunisia and Togo. She was appointed to the EU Commission's expert group on Social Business and has assisted Prof. Yunus on Ban Ki-Moon's MDG Advocacy Group. She holds an MBA from EBS Germany and an MSc in International Relations from LSE and has dual German/Canadian citizenship. Saskia was named Generation CEO 2010 member, a prestigious network of woman in top management in Germany and has recently been named a Young Leader of the Atlantik Brücke, a network promoting transatlantic cooperation. She was a speaker at events in over 15 countries. Saskia was one of the founding members of the Global Social Business Summit, which has developed into a global platform for social business with over 500 participants from over 50 countries.

GEOFF BURNAND, Co-Founder and CEO

Investing For Good

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Geoff had over twenty years' experience in private and institutional investment management before co-founding Investing for Good in 2004. His experience includes designing donor advisory services at The Institute for Philanthropy and Charities Aid Foundation, and as Chief Investment Officer at Charity Bank and as Director of Fund Development at the Social Investment Business. He is a regular speaker at conferences and in the media on social investing and has in-depth knowledge and extensive contacts across the sector both UK and internationally, including philanthropic consultants, social financiers, investment managers, regulators and Government. He is a board member of the UK Sustainable Investment and Finance Association (UKSIF). He is passionate about changing the way people think about investment capital.

MARLENE CARVAJAL, Vice President

DEG - Deutsche Investitions- und Entwicklungsgesellschaft mbH

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Marlene Carvajal is a Vice President at DEG - Deutsche Investitions- und Entwicklungsgesellschaft mbH, headquartered in Cologne, Germany, where she is responsible for evaluating, structuring, and managing private equity and mezzanine direct investments as well as investments in private equity and mezzanine funds. She oversees a multi-sector portfolio of approximately $100 million, focused primarily in Latin America. Before joining DEG in 2008, Ms. Carvajal was a Vice President at Goldman Sachs & Co. in New York in the Asset Management division, responsible for over $5 billion of investments in bonds, derivatives, and stocks, primarily in the US telecom and media sectors. Ms. Carvajal received a Bachelor of Arts in Economics from Boston College and is a CFA Charterholder. She is currently a member of the Board of Directors of Vesta, S.A.B. de C.V. (a publically traded industrial real estate developer/operator in Mexico), and Harmon Hall Holding, S.A. de C.V. (a privately owned English language school in Mexico) and serves on the Advisory Boards of several Latin American based private equity and mezzanine funds.

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Constanze is an associate in our Frankfurt office. She advises clients with focus on domestic and cross border transactions subject to structured finance, in particular real estate, acquisition and project finance.

Constanze studied law at the universities of Heidelberg and Barcelona, Spain. She is admitted as a German lawyer (Rechtsanwalt) since 2007 and furthermore holds a diploma in business administration with particular emphasis on banking and a certificate in Business Excellence from the Columbia Business School, USA. In 2009 Constanze had been seconded to the German branch of a leading Swiss bank. Prior to joining Simmons & Simmons in July 2012, she worked for another major international law firm for several years.

SEB ELSWORTH, Director of Partnerships and Communications

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Seb Elsworth is Director of Partnerships and Communications and Deputy Chief Executive at the Social Investment Business Group (SIB), one of the leading social investors in the UK. Seb leads SIB's external relationships across government, civil society and financial institutions and is a leading commentator on the professionalization of the social sector in the UK.

Prior to joining SIB in January 2012 Seb was Director of Strategy at ACEVO, the professional body for third sector leaders, where he led on policy, communications, research, and leadership development programmes as well as establishing a subsidiary consultancy business.

Before joining ACEVO Seb led Leeds University Union as an elected trustee through major governance reforms which had a wider impact on the student movement at a national scale.

DR. MARKUS FREIBURG, Entrepreneur in Residence, Ashoka, Finanzierungsagentur für Social Entrepreneurship

Ashoka

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Together with Ashoka, Markus is currently building as entrepreneur in residence the first financing agency for social entrepreneurship in Germany. The financing agency helps leading social entrepreneurs to identify appropriate financing instruments and suitable investors so that they can grow their business and increase their social impact.

Prior to this, Markus worked for more than 7 years as top-management consultant for McKinsey & Company in Düsseldorf. Among others things, Markus has gained experience as pro-bono consultant for social entrepreneurs for more than 4 years.

Markus studied Business Administration and Economics at the University of Witten/Herdecke (Diplom-Ökonom) as well as European Studies at the University of Cambridge (M.Phil.). Markus received his Ph.D. from the WHU - Otto Beisheim School of Management (Dr. rer. pol.). His research project analyzed the investment decisions of institutional investors for private equity funds.

MALTE HÖPFNER, Social Entrepreneur and Project Developer

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Malte Höpfner has been working in social entrepreneurship and social business for several years, mainly in developing countries and emerging markets such as Vietnam, Costa Rica and Brazil. Out of university he co-founded Bloom Microventures, an award-winning social enterprise which combined microfinance and responsible tourism and operated mainly in Vietnam. Upon his return to Europe, Mr Höpfner started Philantravel.org, which will make it easier for users to explore and arrange visits to non-profit organisations worldwide. He also works as a project developer for social businesses at the University of Lüneburg's Innovation Incubator, where he and his colleagues are setting up a social business for sustainable plant oil production in Brazil. Before moving into social entrepreneurship, Mr Höpfner worked for GIZ (the German Agency for International Cooperation) in Tanzania. He is particularly interested in the application of social entrepreneurship in international development as well as in inclusive business, social business and BOP approaches. Mr Höpfner holds an MSc in Development Studies from the London School of Economics (LSE), a BA in International Relations from the University of Dresden and studied Development Economics at the University of Ouagadougou, Burkina Faso.

DR. MAXIMILIAN HORSTER, Managing Partner

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Maximilian started and runs Climate Neutral Investments, the finance-focused arm of South Pole Carbon.

Climate Neutral Investments developed the market's most comprehensive database on company greenhouse gas emissions, pioneered the concept of quick and easy investment portfolio carbon footprinting and launched the world's first Investment Carbon Screener on Bloomberg. The company also invented the Climate Credit Card that has been selected recently out of over 500 cards as one of Europe's most innovative credit card and recently won the Intelligent Finance Foresight Award. Maximilian is further in charge of several EU-funded climate change research groups, including one that links greenhouse gas emissions and investing.

Prior to founding Climate Neutral Investments, Maximilian worked in Equity and Fixed Income research roles with Capital Group Companies in Europe, Asia and North America. He was also responsible for relationships with institutional investors across Europe. Maximilian holds a PhD from University of Cambridge and is a frequent speaker on climate change and sustainable investing topics.

South Pole Carbon is the leading provider of climate action solutions. The Swiss company manages over 200 emission reduction projects with over 100 employees in 11 offices around the globe. South Pole Carbon was named "Best Project Developer" for the past three years in a row, has been honored "Swiss Social Entrepreneur of the Year" and recently received the Sustainability Award of Switzerland's ZKB bank.

ROBERT KOLLER, CAIA, German chapter Co-Chair, Partner

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Robert advises on debt capital markets and financial regulatory law. He specialises in securities law, bank and insurance capital as well as funds (especially hedge funds) and the EU fundamental freedoms.

He has extensive experience, inter alia, in advising on debt issuance programmes, covered bonds (Pfandbriefe), SME (Mittelstands-) bonds, sovereign issuers, hybrid capital and assignable loan agreements (Schuldscheine) as well as high yield bonds. Robert also regularly works on pro bono matters.

Robert read law at the University of Graz (Magister iuris) and at the Universidad Autónoma de Madrid (Licenciado en Derecho). He is admitted in Spain as an abogado, in Germany as a Rechtsanwalt and in England and Wales as a solicitor. In addition, he is a Chartered Alternative Investment Analyst (CAIA) charter holder and is the co-head of the CAIA German Chapter.

Prior to joining Simmons & Simmons in June 2012, Robert worked for another major international law firm in Frankfurt for several years and before that for leading law firms in Madrid and Gibraltar.

Besides his client related work, Robert frequently publishes on financial markets related developments.

DR. MAXIMILIAN MARTIN, Global Managing Director

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Maximilian Martin is the Founder and Global Managing Director of Impact Economy. He also serves as Founding Faculty in Residence at Ashoka U and Lecturer in Social Entrepreneurship at the University of St. Gallen. He previously served as Founding Global Head and Managing Director of UBS Philanthropy Services, Head of Research at the Schwab Foundation, Senior Consultant with McKinsey & Company, instructor at Harvard's Economics Department, and Fellow at the Center for Public Leadership, Harvard Kennedy School. He holds an MA in anthropology from Indiana University, a MPA from Harvard University, a Ph.D. in economic anthropology from the University of Hamburg, and is fluent in the following languages: German, English, Spanish, Portuguese, French, Dutch, and Italian. Dr. Martin created the first global philanthropic services and impact investing department for a bank in Europe, the UBS Philanthropy Forum, the first university course on social entrepreneurship in Europe. He has participated in numerous projects and innovations in the impact space and authored over one hundred articles on social entrepreneurship, social business and philanthropy, corporate responsibility, impact investments, and related topics.

KATARINA MELICHERCIKOVA, Policy Analyst

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Katarina Melichercikova, Policy analyst, European Commission.

Katarina is working as a policy analyst for the European Commission in the asset management unit of the Internal Market and Services Directorate.

Her main focus is on improving European measures for investor protection for retail investment products, including structured products and insurance-based investment products. She is also working on new EU frameworks for venture capital funds and social entrepreneurship funds. Prior to joining the Commission services in 2008 she worked for the Österreichische Volksbanken AG, where she was part of the 'Alpha Strategies' team dealing with managed futures funds and structured products.

For her Masters, Katarina studied business administration and finance at the University of Vienna and at ESSEC (École Supérieure des Sciences Économiques et Commerciales). She also holds a postgraduate diploma in international relations of the Diplomatic Academy of Vienna.

JANE NEWMAN, International Director

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Social Finance was established in October 2007 and works to identify ways of improving the access to capital for those looking to drive social change – in September 2010 Social Finance pioneered the Social Impact Bond concept, launching a £5 million SIB to finance a programme to reduce re-offending among short sentenced male prisoners leaving Peterborough prison in the UK. Jane leads the international work of Social Finance, developing an international network of impact investment intermediaries and working with a number of jurisdictions which are exploring such financing. Before joining Social Finance in 2012, she was Director of Governance and Company Secretary of The Social Investment Business, the UK's largest social investor. Jane moved to the social investment sector after a career as a senior corporate partner at a leading international law firm, where she spent time based in London, Germany and China.

DR. KEYVAN RASTEGAR, Attorney, Partner

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Keyvan is a broad-based corporate finance lawyer specialized on cross border private equity, lending, and social, impact and non-profit investments.

Keyvan has experience across the capital structure in debt and equity, from global loans to leveraged buyouts, venture capital, private equity, private M&A and capital market deals.

As a social impact lawyer, Keyvan is active in advising foundations, charities, and their investment advisors on combining philantropic goals with business-minded solutions, and achieving these goals with efficiency and expedience.

In addition to heading up the Austrian office, Keyvan is an active member of the US practice, leading teams of New York lawyers on projects both in the US and internationally.

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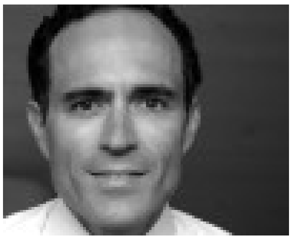

Global Impact Investing Network

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Mr. Weber is a passionate impact investor with more than 20 years of international investment and leadership experience. He is founder of Bridge Impact Capital Ltd. and serves as board member and advisor of various companies, foundations, and family offices. He is a member of the Investment Committee and part of the team that founded the LeapFrog Financial Inclusion Fund, the leading investor worldwide in companies that serve low-income people with insurance and related financial services. Most recently, he was Chief Financial Officer and Chief Operations Officer of a listed financial services firm and responsible for global corporate development at Swiss Re. He spent many years with GE Capital in a variety of leadership roles with responsibilities for Asia and Europe. Mr. Weber is also a founding advisory board member of Partnering for Global Impact, a leading platform for philanthropy and impact investments, and a Global Strategy Partner for Ashoka.

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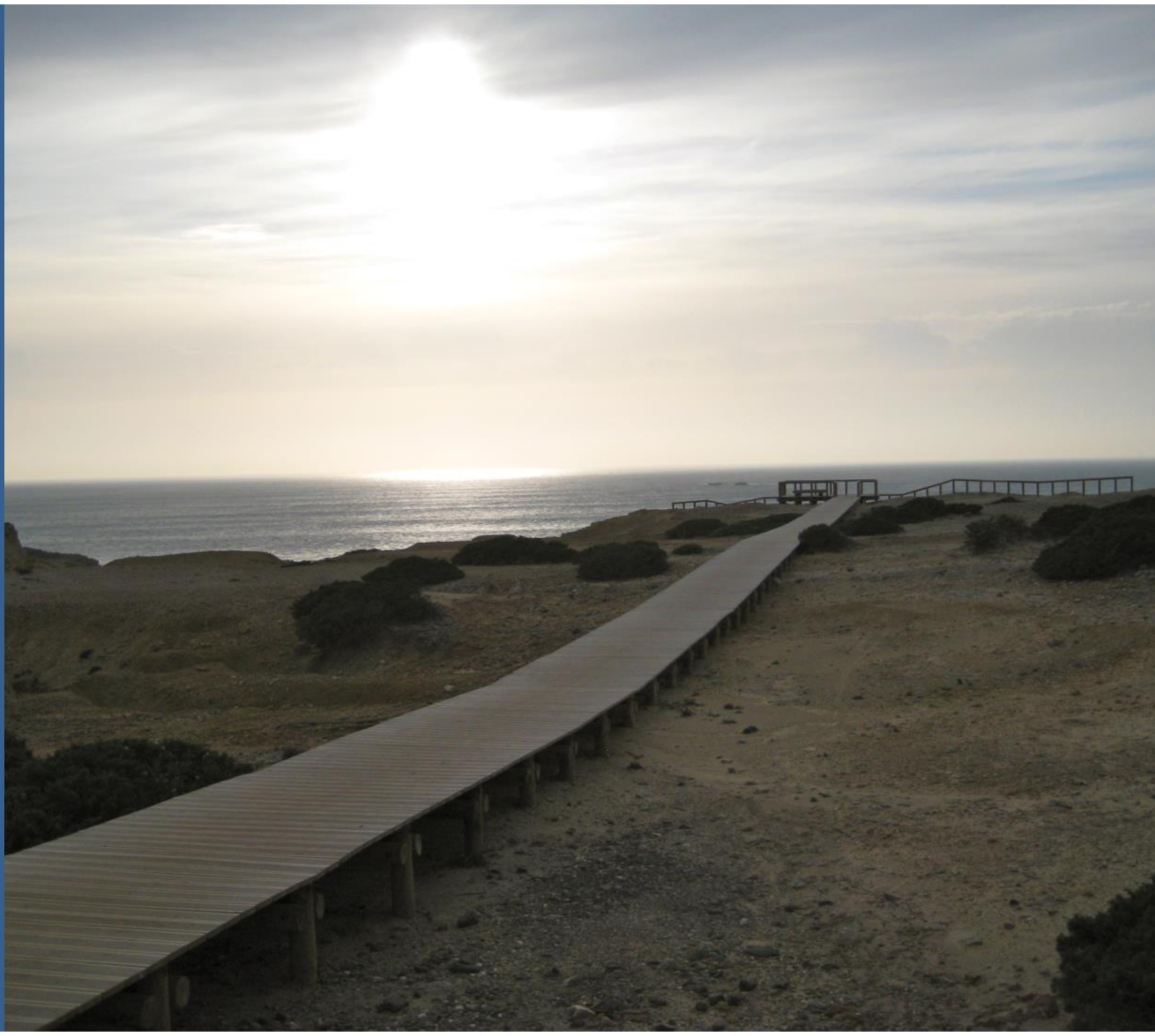

Making Impact Investible

Maximilian Martin

Impact Economy Working Papers
Vol. 4

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About the Paper

Impact investing (also referred to as “social finance”, “social impact investing”, “blended value investing” or “impact finance”) has gained significant momentum in recent years. As we move through the first quarter of the twenty-first century, this is perhaps the biggest idea to renew the relevance of finance for the real economy and social progress. Estimates indicate that impact investing could become a new asset class or investment style that will grow to USD 1 trillion by the end of the decade. Paralleling the emergence of impact investing, research is proliferating. It aims to understand the phenomenon and strengthen the market building process currently underway.

At Impact Economy, we have worked on impact investing with a variety of clients and partners since the inception of the firm with our dedicated “making impact investible” team. Over more than a decade, the author of the study has been involved in a variety of senior roles in the pioneering efforts that have led to the creation of the concept of “impact investing” in 2007-2008, investment ideas such as contingent return models that link a financial return to a social outcome, and in their mainstreaming. In 2011, we reported interim results of this work including an investor survey to a group of stakeholders and called for a “Geneva Consensus” to enhance the practical investibility of impact investing.[1]

It is now time to take stock and ask how we can seize the potential and leverage impact investing to make a meaningful difference in the challenges facing our generation. Accordingly, this working paper reviews the state of action in impact investing, its potential for mainstreaming and the pathways for doing so. For the study, we screened more than 200 impact investment-related reports in a number of languages, including English, French, German, Italian, Portuguese, Spanish, Japanese, and Russian. We also conducted a media search of 26 terms related to, or viewed as some variant of, “impact investment” in six languages and returned a total of 181,357 hits (of which only 13,691 came from non-English sources), and generally leveraged our industry expertise.

The paper begins by providing a framework of understanding for the “impact investing” term, its forms of capital, institutional landscape, and blockers as well as enablers of further market growth. It then locates impact investing in the broader context of four megatrends that are creating new investment opportunities, namely massive pent-up demand at the “Bottom of the Pyramid”, the need for radical resource efficiency and green growth, the restructuring of the welfare state to drive efficiency, and the rise of “Lifestyle of Health and Sustainability” (LOHAS) consumers. We subsequently explore how to best stimulate the impact investment marketplace via capital supply, capital demand and capital use policies. The paper provides a look at the emerging ecosystem of impact investing and the role different groups of investors play, including philanthropic investors such as foundations, angel and venture stage investors, private and institutional investors, and financial services institutions. The paper concludes with recommendations for how to fully unlock the potential of impact investing, taking the sector from niche to mega as one might say. In a nutshell, two impulses are critical at the current stage of industry development: (a) intelligent policy action to build the impact investing market; and (b) sorting out social impact measurement to achieve reliable metrics for impact. The final section provides select suggestions for further reading.

Building on more than three years of research on impact investing, and serving as a finance-focused companion to the real-economy study “CSR’s New Deal”, this working paper is also intended to provide a market and trend context to inform the wider “Building the Impact Economy Initiative” we have currently underway. The Initiative analyzes the development trajectory of a variety of industries and their potential to move sustainability from a bolt-on concept to an embedded core feature of business, thus driving both long-term profitability and greater ecological and social viability as we design and implement next gen solutions. The Initiative is set to culminate in an edited volume to be released by Springer, prepared by Dr. Maximilian Martin (editor), and currently envisioned to be co-edited by William Burckart, who are joined by a number of high-profile chapter authors.

[1] “Calling out for a ‘Geneva Consensus’ on impact investing”, Impact Economy, accessed April 1, 2013, http://www.impacteconomy.com/impact-investing-prestudy-launch.

1. What Is Impact Investing? Understanding the Unit of Analysis

The practice of impact investing has grown into a USD 36 billion industry over the course of just a few years. While this sounds like fast progress since the inception of the term "impact investment" in 2007, the exponential growth potential will continue for a number of years. This section defines the concept, explains the pathways for impact investment capital, and provides an overview of the impact investing landscape.

The aftermath of the financial crisis has opened the door for a thorough reassessment of the contribution of finance to economic progress and the greater public good. Combined with continued globalization, shifting attitudes toward the role of government, a technology and communications revolution underway in all corners of the globe that now allows us to hold an astonishing amount of information literally in the palm of our hands, as well as concerns about the long-term environmental and social sustainability of the global economy, these developments are not just changing the way people interact and do business with one another, but also how we allocate capital.

This paper explains a recent phenomenon in the financial industry, namely the rise of impact investing, or the notion that financial capital can intentionally achieve environmental and social outcomes as well as financial returns. Today, impact investing is still a niche phenomenon: a USD 36 billion industry. But we are on the verge of a very significant development. An estimated industry potential to grow to USD 400-1000 billion by 2020 raises two key questions[2]:

- (a) How can this be achieved in practice given the still relatively minor "stock" of impact investments around the world; and
- (b) In how far is this relevant to solving large-scale economic and social challenges (and thus worthy of market-building support).

There were over USD 600 trillion in financial assets globally in 2010, representing claims against a nominal global GDP of roughly USD 63 trillion. By 2020, there will be roughly an estimated USD 900 trillion in financial assets, representing claims against about USD 90 trillion/year of global GDP.[3] Taken with current projections, impact investing might grow to only 0.1 percent of all financial assets by the end of the decade.

However, the impact may be much larger than suggested by this figure. There are several reasons. Many of humanity's same old social problems persist despite the benefits reaped from globalization and the technology revolution. Countries spend trillions of dollars combating these challenges, yet evidence suggests that this strategy is not working as well as it might. While the pace of human population growth by 2050 is expected to fall to more than half of its peak in 1989, we can expect a global population of 9 billion, not to mention an older population because of increased access to more and better information about healthy living along with advances in medicine.[4] With less people working and more people living well into their 80s, 90s, and longer, our social systems, and the problems embedded within them, will get harder to fund. A recent study by Accenture and Oxford Economics projected the expenditure gap between expected demand for services and the ability to pay for them through to the year 2025. The results were startling: for Canada, the gap was USD 90 billion; France, USD 100 billion; Germany, USD 80 billion; Italy, USD 30 billion; the UK, USD 170 billion; and the US, USD 940 billion.[5]

We will need new pathways and solutions to finance this gap and other challenges. In the 2000s, microfinance – or financial systems at the bottom of the population pyramid that broaden access to capital for individuals with low income – transformed the view of the poor from non-bankable recipients of assistance to productive entrepreneurs that can build wealth and take part in the mainstream of the

[2] Nick O'Donohoe et al, "Impact Investments: An emerging asset class," *J.P. Morgan* (2010): 6, accessed May 1, 2013, URL: http://www.rockefellerfoundation.org/uploads/files/2b053b2b-8feb-46ea-adbd-f89068d59785-impact.pdf.
[3] Bain & Company, "A World Awash in Money: Capital trends through 2020," *Bain & Company* (2012): 3 and 7, accessed May 1, 2013, URL: http://www.bain.com/Images/BAIN_REPORT_A_world_awash_in_money.pdf.
[4] "Population," Wikipedia, accessed May 1, 2013, URL: http://en.wikipedia.org/wiki/Population_growth.
[5] Accenture, "Delivering Public Service for the Future: Navigating the Shifts," *Accenture* (2012): 4, accessed May 1, 2013, URL: http://www.accenture.com/SiteCollectionDocuments/PDF/Accenture-Delivering-Public-Service-for-the-Future-112812.pdf.

economy. As an asset class with USD 40 billion in outstanding loans, as of 2010, microfinance has influenced international development and financial regulation in emerging economies, driving much more significant progress than the mere size of outstanding loans would suggest.[6] With major adjustment challenges ahead in the domains of education, healthcare, unemployment and the environment, impact investing can potentially play a similarly catalytic role just on a much more comprehensive scale: the opportunity is to leverage the innovative entrepreneurs, trillions of public and private money, and financial innovation to benefit society at large, turning our most enduring social challenges into opportunities.

1.1. Term and Context

As a term, "impact investing" was coined in 2007. The Global Impact Investing Network (GIIN) defines it as: "investments made into companies, organizations, and funds with the intention to generate measurable social and environmental impact alongside a financial return."[7] The word "intention" in this characterization differentiates these investments from socially responsible investments. The latter aim to *avoid* social or environmental harm emanating from an asset that is otherwise managed for a single bottom line: profit.[8] An impact investment can be made in developed and emerging countries and seeks below market or market-rate financial returns. This characteristic makes it different from a grant, which is simply a donation of funds with no expectation of returns. Program-related (PRI) and mission-related investments (MRI) are types of impact investments made by charitable foundations with vastly different rules governing their use.[9]

In the big scheme of things, the impact investing industry today is still small. But its stock of USD 36 billion is growing fast, with approximately 2,200 impact investments worth USD 4.3 billion made in 2011, USD 8 billion in 2012, and planned USD 9 billion in 2013. The potential returns of impact investments in emerging markets in particular are compelling. A 2010 study by J.P. Morgan, based on a survey of impact investors, found that the expected returns of many existing impact investments in emerging markets fall largely in the 8-11.9 percent bracket for debt investments, and into the 20-24.9 percent bracket for equity. This compares to developed market returns expectations of 5-7.9 percent and 15-19.9 percent in debt and equity respectively.[10] This sounds quite exciting when compared to financial return expectations in the low-growth environment of the European Union, which has been in recession for a year and a half. But impact investment is not simply an emerging markets phenomenon. In the UK, the RBS Social Enterprise 100 index is now in its second year. It aims to track the success of social businesses across the UK, and examines both their growth and the impact that they make. The SE100 Index not only showed high average growth, but the growth in revenue by index entrants is thus far impressive when compared with both the FTSE100 and the SME sector.[11]

All of the above raises the question of how this market emerged in such a short period of time. Private foundations, through grants, PRIs, and MRIs, have historically played a vitally important role in building the market to the current size. High net worth individuals and families have operated similarly. Apart from a few champions, large financial institutions, including banks and pension funds, have been more hesitant to join the effort, even though they are now gradually beginning to do so. Development finance institutions (DFIs) have made an important contribution through their role in the growth and professionalization of microfinance (which can be considered a subset of impact investing that focuses mainly on funding economically active low-income populations in the informal sector). DFIs have traditionally contributed

[6] Elisabeth Rhyne, "The State of Global Microfinance: How Public and Private Funds Can Effectively Promote Financial Inclusion for All" (testimony presented before the Subcommittee on International Monetary Policy and Trade, Committee on Financial Services, U.S. House of Representatives, January 27, 2010), accessed May 1, 2013, http://financialservices.house.gov/media/file/hearings/111/rhyne_testimony.pdf.
[7] "About Impact investing," GIIN, accessed on May 1, 2013, http://www.thegiin.org/cgi-bin/iowa/resources/about/index.html.
[8] This paper uses "social impact investment" as coterminous with "impact investment", unless otherwise specified.
[9] David A. Levitt, "Investing In the Future: Mission-Related and Program-Related Investments for Private Foundations," *The Practical Tax Lawyer* (2011). Accessed May 1, 2013. URL: http://www.adlercolvin.com/pdf/PTXL1105_Levitt.pdf.
[10] Marco Arosio, "Impact Investing in Emerging Markets," *Responsible Research* (2011), accessed May 1, 2013, URL: http://www.sustainalytics.com/sites/default/files/impact_investing_in_emerging_markets-issues_for_responsible_investors.pdf.
[11] Social Enterprise, "The RBS SE100 Data Report 2011: Charting the Growth of the UK's Top Social Businesses," *Social Enterprise and RBS Community Banking* (2011), accessed May 1, 2013, URL: http://www.socialenterpriselive.com/sites/default/files/files/supplements/SE100_DataReport_Web1.pdf.

funds and expertise to all five of the major pathways to invest in microfinance, including direct equity, specialized funds, lending and guarantee schemes, investment banking and structured products, as well as peer-to-peer investment. They can be expected to play a similarly enabling role in the impact investing industry.

In addition to being a way of investing, impact investing is also a powerful *idea* for how to reconcile the world of investments with the greater public good. It draws much more significant media attention than the size of the industry alone would suggest and an inflow of talent from the financial industry is noticeable. The demand-side of the industry consists of companies such as small and growing businesses, as well as financially viable non-profit social enterprises with an earned income, and cooperatives. Rather than legal form, their common denominator is that they all work under the premise of both a financial and an extra-financial bottom line (“social impact”). These “social enterprises”, “impact enterprises” or “impact businesses” receive and utilize impact investments from investors who want to both “do good” and “do well” with a part of their portfolio. Thus far, professional investors, specialized funds, and governments have been the main capital providers for impact investing, even though their motivations can differ: some want low-volatility opportunities and/or segments of the market uncorrelated with mainstream global benchmarks; others have an investment theme-orientation (e.g. education, environment and renewable energy, healthcare, housing, small enterprise, sustainable development, or water); and a third group wants to achieve social or environmental objectives more efficiently via investments rather than grants. Depending on the prioritization of financial vs. impact goals, an investor can be characterized as a “financial first” or “impact first” investor.[12] Next to these capital providers and capital recipients, the impact investment market also involves intermediaries, government, and professional service providers.[13]

1.2. Forms of Impact Investment Capital

Impact investments pursue at least a double bottom line, achieving financial returns as well as social or environmental outcomes. At a fundamental level, however, the same basic tool of finance and categories of capital are as applicable here as they are in mainstream financial markets, namely grants (not an impact investment but a subsidy), debt funding, shareholder equity, and mezzanine capita (also referred to as convertible debt) – as well as any combination of the four to achieve funding and impact goals (so-called “hybrid capital”). Moreover, impact investors need to decide whether they want to make a direct investment into a social enterprise, fund an investment intermediary (e.g. an impact investment fund) that then invests in the underlying investees, or engage in other transactions such as absorbing risk by providing guarantees, first loss tranches, credit enhancements, or currency hedging. With the tools of structured finance, a host of impact investment products can be engineered, including those where the underlying asset loses money but the impact investor nevertheless receives a positive financial return upon achievement of a social outcome (this is the case of the “social impact bond,” discussed further below). To establish a shared understanding, this section defines the four categories of capital.[14]

Grants are defined as funds disbursed by one party to another party without any expectation of repayment. Grant makers typically are government agencies, charitable foundations and trusts, or private sector entities. Recipients are often non-profit entities and educational institutions, but also individuals and businesses. Grants can be provided either through money, or in-kind via volunteering or contributions. To obtain a grant, some kind of grant application or grant proposal is typically required. Most grants are made to fund a specific activity or project; they require some level of reporting to the funder. If the grant seeker

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[12] Monitor Institute, “Investing for Social & Environmental Impact: A Design for Catalyzing an Emerging Industry,” *Monitor Institute* (2009): 31, accessed May 1, 2013, URL: http://www.monitorinstitute.com/downloads/what-we-think/impact-investing/Impact_Investing.pdf.

[13] E.T. Jackson and Associates Ltd., “Accelerating Impact: Achievements, Challenges and What’s Next in Building the Impact Investing Industry,” *Rockefeller Foundation* (2012): 9, accessed May 1. 2013, URL: http://www.rockefellerfoundation.org/uploads/images/fda23ba9-ab7e-4c83-9218-24fdd79289cc.pdf.

[14] For an analysis how the different forms of capital can be used to fund social enterprises, see Maximilian Martin, “Understanding the True Potential of Hybrid Financing Strategies for Social Entrepreneurs,” *Impact Economy Working Paper* 2 (2011), accessed April 15, 2013, URL: http://ssrn.com/abstract=2208370. This section uses the definitions laid out in there.

has a charitable or tax-exempt status, the funder may be able to deduct the grant or a portion of it from his tax obligations. In spite of the advantage of providing capital at zero cost, there are important limitations to grant funding. First, grants are typically project specific. They exclude overhead and business development costs, and do not provide full internal capital allocation flexibility. Second, grants usually face a limited 3-5 year time horizon. And third, they are costly to raise – estimates of the amounts raised that are lost to costs range from 22-43 percent. Finally, grants are project-related. Grants are very valuable to get started but they by and large cannot accompany a social entrepreneur’s rising capital needs as the enterprise goes to scale.[15]

Debt capital is defined as capital that is raised by taking out a loan. There is typically an expectation to be repaid at some future date when a loan is made to a social enterprise. The repayment schedule may be structured depending on repayment ability. For example, a balloon payment loan does not fully amortize over the term of the loan, and leaves a large final payment, the so-called balloon payment. Unlike in the case of equity capital, subscribers to debt capital do not become part owners of the social enterprise, but remain creditors. Debt capital is therefore an especially important source of external financing when social enterprises are structured as non-profits. Suppliers of debt capital usually receive a contractually fixed annual, or in some cases floating, percentage-return on their loan. They provide capital on a temporary basis, with repayment due after a few years. The interest on debt capital must be repaid in full before any dividends are paid to any suppliers of equity. From a business development perspective, debt capital is an attractive option whenever (a) long-term investments with stable and predictable cash flows need to be funded, (b) if the social enterprise is fundamentally creditworthy and (c) able to make an annual interest payment. Risk capital is often required to take on debt and provide layers of risk, and non-profits who cannot take on equity may need to raise grants that perform the layered risk function of equity. Moreover, in the event of bankruptcy, debt capital providers may have far-reaching rights on the organization’s assets.

Shareholder equity, also referred to as risk capital, is the residual claim or interest of the most junior class of investors in assets, after payment of all liabilities. This means that equity is positive if valuations on assets exceed liabilities. Equity capital is an attractive external financing option for social enterprises structured as for-profit entities (thus able to accommodate shareholders). They can fund activities that are necessary to scale the venture but have an uncertain payoff or income generation schedule. Unlike in the case of debt, equity does not have to be repaid. Shareholders bear the full risk of the operation in exchange for certain control rights. In the event of bankruptcy of the social enterprise, all secured creditors are first paid against proceeds from assets. Subsequent claims on the residual proceeds are based on the creditor’s ranking in the priority sequence; shareholders equity is then the residual claim against assets, which is paid only after the demands of all other creditors have been satisfied. Access to such risk capital is essential to scale most social enterprises. In exchange for a certain share of the company, the investor receives a share of the future profits generated by the social enterprise, rather than regular annual payments. Given the inherent riskiness of equity, investors also receive certain control and voting rights. The rights depend upon the share held in the social enterprise and the legal framework in the country where it is registered. This means that an impact investor needs to carefully consider whether his “DNA” as an equity investor is compatible with the values and philosophy of the social enterprise.

Mezzanine capital or **convertible debt** is a combination of debt and equity capital. It can be a useful alternative or complement to other funding sources, or if pure equity or debt capital cannot be accessed. Mezzanine instruments refer to either a subordinated debt or a preferred equity instrument that represents a claim on a social enterprise’s assets. This means that repayment is required and ownership goes undiluted. The interest payment can be linked to the profits of the company whereas the total amount is repaid after a certain time period. Mezzanine financing is senior only to common shares and can be structured as unsecured debt or preferred stock. Given its higher risk, it is typically a more expensive financing source.

[15] William Meehan, “Investing in Society,” Stanford Social Innovation Review (2004), accessed May 1, 2013, URL: http://www.ssireview.org/articles/entry/investing_in_society/.

Finally, **hybrid capital** is a combination of the forms of capital listed above. To illustrate how hybrid capital can serve to take a social enterprise forward, consider the case of Husk Power Systems (HPS). Regarded as a leading social enterprise in India, HPS uses the throwaway portion of rice husks to generate electricity. Despite the fact that the company had a viable solution that could be scaled to bring electricity to the more than one billion Indian residents without electricity, Husk was turned down time and again by the Indian government and private investors for expansion. In 2009, OPIC saw the company’s possibilities and made, by its standards, a relatively small loan of USD 750,000. “OPIC’s funding was a game-changer for us,” said Husk President Manoj Sinha. “OPIC proved that a project like this was debt financeable, and could therefore offer attractive returns for venture capitalists and more conservative investors, by leveraging assets. It’s not easy finding a loan in India, so OPIC proved to be a real shot in the arm for us.”[16] For its subsequent Series A share offering in 2011, HPS sought equity capital of USD 5 million and debt capital of USD 7 million to fund the execution of its ambitious expansion plans to meet its growth target for 2013.[17] Equity capital was intended to be used to recruit and train senior and mid-level managers for operations, rollout a franchisee model and to support R&D activities geared towards streamlining operations. Debt capital was earmarked for purchasing equipment. Management also envisioned a “Series B” equity round of USD 15-20 million and around USD 30 million in debt, to enable the firm to expand to 12,500 villages by 2016. Alternatively, HPS was also considering pursuing strategic buyers or private equity investors and aimed for a liquidity event for its investors in 2015.

1.3. Blockers and Enablers

The growth, and visibility, of the impact investment industry has been remarkable. But significant challenges remain. Industry players generally point to the lack of track record of successful investments as a main concern, and argue that too few established players are active in impact investing. Moreover, there are no universally accepted ratings of impact investments and there is a lack of appropriate products. Performance concerns and a lack of impact investment opportunities are also regularly cited as blockers for market development. The absence of a universally accepted rating standard reflects a lack of consensus about the language of social impact.

For example, if an investment ends up creating three jobs, the “output” of that investment would be three jobs and the “outcome” would be increased wages to the three workers, employment taxes to the state, or reduced government support payments. If one of the three workers would have found work without the investment, the “impact” can then calculated based on the two “net” people that started work.[18] It is not trivial to come up with reasonable assumptions about causality and track impact over time. Those pushing for wider adoption of impact investment instruments note that the inability to settle on one definition is preventing the sector from acceleration.[19]

Institutional players are bound by much stricter fiduciary obligations than private investors. The lack of track record of successful investments and shortage of attractive and scalable investment opportunities need to be addressed in order to enable institutional actors to engage in impact investing on a major scale. A further topic is profitability and impact: some impact investments are structured by “layering” financial instruments, such as grants and PRIs in order to achieve impact, but this makes it harder to precisely define

[16] “Renewable Energy in India’s Rice Belt: Husk Power Systems,” OPIC, accessed May 1, 2013, http://www.opic.gov/projects/husk-power-systems. For a comprehensive treatment, see Maximilian Martin, “Understanding the True Potential of Hybrid Financing Strategies for Social Entrepreneurs,” *Impact Economy Working Paper 2* (2011): 23-26, accessed April 15, 2013, URL: http://ssrn.com/abstract=2208370.

[17] Series A Shares typically are the most preferred tier of classified shares and offer more voting rights than later rounds of funding via Series B Shares etc.

[18] nef consulting, “Measuring social impact: the foundation of social return on investment (SROI),” *nef consulting* (2004): 3.1, accessed on May 1, 2013, URL: http://sroi.london.edu/Measuring-Social-Impact.pdf.

[19] John Simon and Julia Barmeier, “More than Money: Impact Investment for Development,” *The Center for Global Development* (2010):3, accessed on May 1, 2013, URL: http://www.cgdev.org/sites/default/files/1424593_file_More_than_Money_FINAL_web.pdf.

the impact.[20] Generally, it is difficult to imagine impact investing going to scale if it presents itself as the "poor cousin" of investing.

Despite the challenges, impact investors are forging ahead with investment deals all over the world, proving time and time again the appeal of the concept of impact investing, and that it is possible to earn both a financial and social return simultaneously. In the process, they have created major financial innovations that can be replicated on a large scale— such as social impact bonds (SIB) that were first piloted in the UK to address issues of recidivism and have since been adopted in other parts of the world to combat other serious social challenges. Yet without a facilitating hand of market-building players and government agencies, the impact investing industry is likely to continue to scrap and fight to make erratic progress, just as it has done from the start. With more concerted and coordinated government action, though, impact investments can even help achieve large-scale policy objectives such as job and business creation, economic recovery and growth, and new investments into burgeoning industries, such as renewable energy.

[20] "Layering" financial instruments is known more broadly as "tranche" financing. This is the practice of slicing the risk of an investment into different segments, or "tranches." This setup provides multiple investors with different risk and reward appetites an effective way to engage in a given transaction. Due to their charitable disposition, foundations have the unique ability to take the riskiest positions in such structures, thereby absorbing the highest risk positions and incentivizing the participation of other investors. For more information about the use of PRIs and grants in layered impact investments, see Lester M. Salamon and William Burckart, "Foundations as Philanthropic Banks," in *New Frontiers of Philanthropy*, ed. Lester M. Salamon. (Oxford University Press, forthcoming).