MAKING SENSE OF THE SOCIAL CAPITAL LANDSCAPE:
Defining A Common Language

prepared by Shari Berenbach, Laura Callanan, and Kevin Jones for the SOCAP08 Conference

INTRODUCTION

SOCAP08 is a global gathering of social venture funds, institutional investors, development agencies, large and small foundations, private philanthropists, angel investors, and others. Each of us recognizes that something new is happening and that **something new is possible** towards social change. All of us have come to **SOCAP08** committed to exploring the promise that money and impact can mix in new ways to greater effect.

We see in this world a range of investment opportunities that span sectors and geographies, for-profit and non-profit, direct and through intermediaries. While diverse, each share common goals of unleashing the power of enterprise to tackle long standing social and economic challenges. **Consider:**

EDUCATION: Associacão Nacional de Cooperacão Agrícola (**ANCA**) is a Brazilian cooperative nonprofit organization that represents the settlements connected with the **Movimento Sem Terra** (Landless Workers Movement). **ANCA** provides educational opportunities to school age children, as well as adults and community activists, by producing publications for the training and education of leaders in various worker movements. Approximately 7,000 books are sold each month, and that number continues to grow. **ANCA** has taken soft debt from a range of investors to provide working capital, and financing to its members.

HEALTH: Voxiva is a for-profit voice and data solutions provider that has developed new ways to use technology to address some of global health's most pressing challenges. From disease surveillance to adverse event reporting, **Voxiva**'s applications allow public health agencies from Peru to Iraq to collect critical data from, and communicate with, front-line health workers in real-time, empowering them to respond immediately. Investors have placed "patient" equity into this social venture to grow the budding enterprise.

HOUSING: The Federation of Appalachian Housing Enterprises (**FAHE**) is an association of 30 nonprofit housing organizations producing affordable housing for low-income families across Appalachia, one of the most impoverished regions in the US. **FAHE** clients have a median family income of $12,110. Cumulatively, FAHE groups have constructed or preserved almost 40,000 affordable homes. As a nonprofit, **FAHE** has been able to put to use millions of dollars in soft debt from investors to finance its housing activity.

ENTERPRISE DEVELOPMENT: MicroVest is a debt and equity fund that invests in leading microfinance institutions throughout the developing world. It has raised limited partnership equity units to form a core of capital, to which it adds leveraged debt raised from individuals and institutions throughout the 10 years of the LP. It blends debt and equity, and private partnership and nonprofit structures.

MEDIA: The Media Development Loan Fund (**MDLF**) is a nonprofit organization dedicated to assisting independent news outlets in emerging democracies to develop into financially sustainable media companies. **MDLF**'s invests in a range of debt and equity placements to TV and radio broadcasters, newspapers, magazines, news agencies and on-line media across Eastern Europe, the former Yugoslavia, the former Soviet Union, Asia, Africa and Latin America. As such, **MDLF** is a revolving fund that takes soft debt from a range of investors.

This convening will bring together investors who value these sorts of transactions, as much for the social impact they generate as the potential for financial returns. **SOCAP08** will convene more social venture funds (defined as investment vehicles raising money from investors who want both a financial return and high social impact) than have ever before assembled. These funds hail from South Africa, Brazil, Denmark, Mali, the UK, Mexico, and the U.S. Along with the funds, we have foundations who seek to use their capital in new ways to achieve their missions; American and European development agencies mobilizing markets for the poor; and individuals who won't choose between being either donors or angel investors.

Each of these groups speaks its own language -- theory of change or value proposition, paradigm shifts or disruptive techniques. The goal of this brief conversation starter is to foster a common framework that will make cooperation and joint action more possible. We plan to use the Financial Risk/Return Quadrants and the Social Impact Landscape described in this paper as a contextual visual aid at **SOCAP08**. We are asking all participants to place themselves on these two maps. Hopefully, this will help all of us to find our natural partners and collaborators.

By coming together we show each other -- and the world -- that there is a movement emerging that mixes risk, return and impact in a new way. We hope by the end of our time together we will have advanced our shared vocabulary for talking about our work with one another, and with new collaborators we have yet to discover.

MAPPING FINANCIAL RISK AND FINANCIAL RETURN

*DEFINING BRIGHT LINES

At the base of a broader discussion regarding the relationship between risk, return and impact, is a more straightforward assessment of financial risk and return. Of course, conventional financial theory assumes that financial risk and return are correlated, and that profit maximizers always seek the greatest financial return relative to the risk.

***Once social impact factors enter into consideration, however, a more robust set of issues need to be taken into the decision process. You can't necessarily assume that greater financial risk, will on average, generate greater financial return.**

In fact, in this broader social capital market, it is just as likely that greater financial risk might be accompanied by lower financial return—and this could be financial return so low that there are varying degrees of **loss of principal**. This is particularly the case once investors net out transaction costs and investment management costs – which in this social space could well be multiples of costs typically encountered in the conventional investment process.

The important point here is that as 'investors' accustomed to correlating risk and return enter this market, it becomes essential to:

» Recognize that they are walking outside the conventional, assumed relationship between risk and return, and,

» Foster greater transparency, becoming more explicit about the risk and return **targets** that are seeking and willing to accept.

PLEASE TAKE FOR EXAMPLE:

Kansas City Neighborhood Alliance – This thirty-year old, award winning community development corporation developed more than 400 affordable housing units and served as the economic engine for growth in Kansas City, Missouri and parts of Kansas City, Kansas. Despite these proud achievements, by year-end 2007 **KCNA** was forced to close its doors. Weak markets, declining property value – and changing priorities of key funders left this venerable organization in a precarious position. **KCNA** is in the process of liquidation and as of this date no payments to creditors have been made other than for service providers who needed to be paid to continue service (insurance, audit, storage of records, etc.). They are currently trying to sell/liquidate their major projects which have secured creditors and will be working with the creditors on those sales as they occur.

Environmental Enterprise Assistance Fund – Launched in 1990, the **Environmental Assistance Fund** began by financing small and medium enterprises (**SME**) producing green technology around the globe. Over time they recognized that the costs of operating a single global fund proved unsustainable and they reoriented their operation to a fund management model. As a fund manager, however, the economics were still problematic – exits were difficult to accomplish, yields illusive and the economic turmoil of the 90's prompted an orderly wind-down of assets. Investors walked away with roughly 35 cents on the dollar.

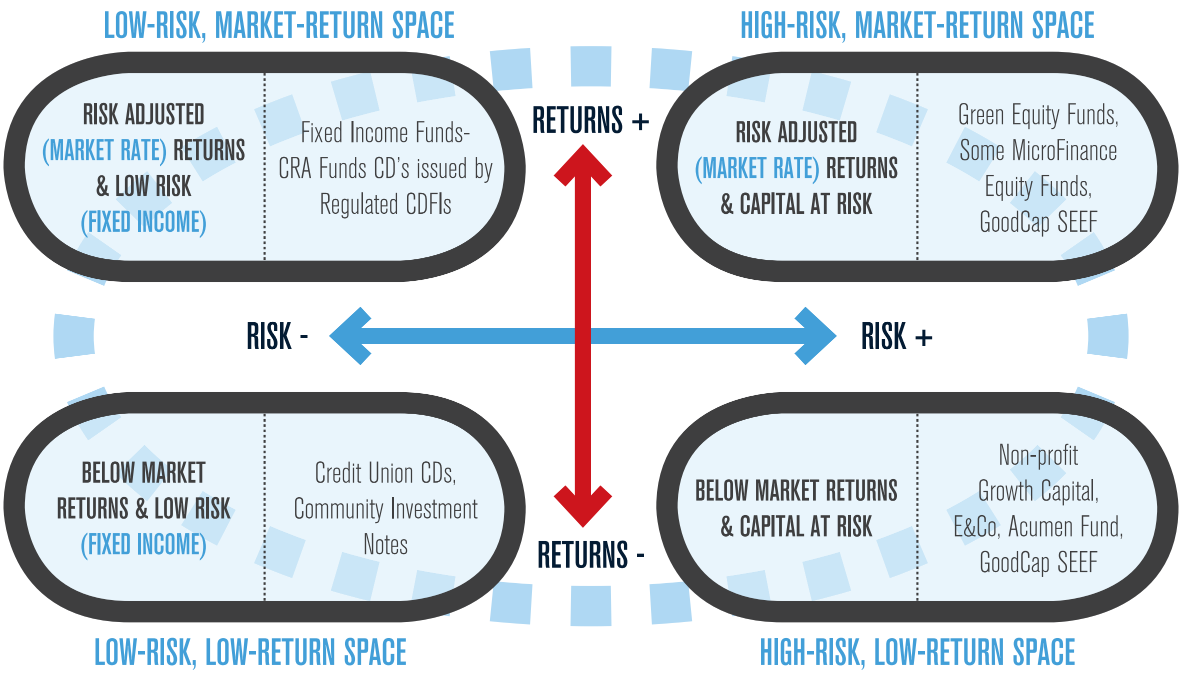
From a total value proposition standpoint, investors might have believed that the potential or achieved social impact was sufficient for them to have fully or partially risked their investment capital. Clearly, in conventional philanthropy, investors routinely forgo financial return and even capital preservation to attain their desired social impact.

FINANCIAL RISK/RETURN QUADRANTS

To foster **greater transparency and alignment between expectation and performance**, we encourage adoption of what might be considered two bright lines:

» **Bright Blue Line (risk):** Whether (or not) an investment seeks to provide – and is reasonably likely to provide -- a risk adjusted financial return

» **Bright Red Line (returns):** Whether (or not) the investor has reasonable certainty of capital preservation.



While a simple construct, this model becomes useful as one seeks to populate this with real examples. For example, in the **High-Risk, Market-Return Space**, some green energy private equity funds are generating market-making or marking-beating returns – as is the case of some microfinance equity funds. On the fixed income side, investment-grade bond funds dedicated to CRA investing are meeting or surpassing their fixed income counterparts. As well, some regulated community development banks provide yields on certificates of deposits that are consistent with or better than the banking sector overall.

In the **Low-Risk, Low-Return Space**, the **Calvert Community Investment Note** is a good example. The yield offered (currently maximum three percent) doesn't necessarily keep up with CD or treasury rates, but the **Community Investment Note** is managed as a safe alternative for investors and draws upon substantial credit enhancement. CD's issued by smaller credit unions, in fact, may be federally insured, but lag yields offered by more robust banking entities. The rationale for investing in the **Low-Risk, Low-Return Space** would lie, not on the potential for maximum return, but the relative safety for principal while achieving more profound social impact. These investment options are lending in poorer communities, to subsistence farmers, to self-employed women, or to day care centers, and charter schools. Such investments provide the critical, enabling softly priced capital that allow housing projects to reach families with very low-income.

In the **High-Risk, Low-Return Space**, we combine less than risk-adjusted returns with investment uncertainty. **Acumen Fund**, which historically had been funded exclusively by grants has recently launched an investment fund. They will be the first to acknowledge that Acumen Fund is compounding venture risk, with country risk, and new market risk. **E&Co** is another good example here – while **E&Co** has recently issued a debt product to investors – this capital is placed on subordinated terms into individual small businesses across the globe. Again, while historically funded through grants and investments from international institutions or foundations – **E&Co** is now ramping up with investor capital. Both **Acumen** and **E&Co** in their more recent investment offerings are intending to generate modest returns – relative to the risks investors will be taking on.

Will the returns be there? Maybe yes, maybe no. What happens if too large a share of their portfolio experiences write-downs? What happens if the significant operating grants taper-off? Let's keep in mind that the expense ratios of funds like **Acumen** can reach into the double digits. What if yield is consumed by the operating expenses needed to manage and provide technical support to the portfolio companies? There are many who will argue that funds like **Acumen** and **E&Co** merit such investments – even if in the end yield is uncertain -- given that they are opening whole new markets – and addressing fundamental concerns such as poverty alleviation, health and global warming.

There are as yet another set of funds, that might strive to achieve market rates of return – but it is too early to say if these returns will likely be attained. **Good Capital**'s **Social Enterprise Expansion Fund** is a case in point. They are taking a highly rigorous approach to selecting transactions, evaluating both the potential for social impact and financial return. This Fund may be investing in for-profits and non-profits, at different stages of maturity and across diverse sectors. Will the **Social Enterprise Expansion Fund** yield returns in the high single digits, the teens? Or higher? Do such yields qualify as the **Low-Risk, Market-Return Space** or the **Low-Risk, Low-Return Space**? How do you assess which funds are really likely to deliver return above or below this bright blue line? What is the appropriate financial return benchmarks? For funds truly placed in the **Low-Risk, Low-Return Space**, is the social impact potential commensurate with their social and financial risk/return profile?

This Fall 2008 is perhaps a good time to drill down and revisit concepts of risk adjusted return and capital preservation given the current pressing challenges before Wall Street. We are learning that even conventional markets can fail to appropriately evaluate risk in light of continued financial innovation. The challenges to adequately address risk and return is all the more magnified once you step outside the framework of tested business models, benchmarking data sets, ratings, third-party investment analysts. The market infrastructure that reduces transaction costs and ensures greater uniformity in the pricing and assessment of risk has yet to fully emerge in the social capital market..

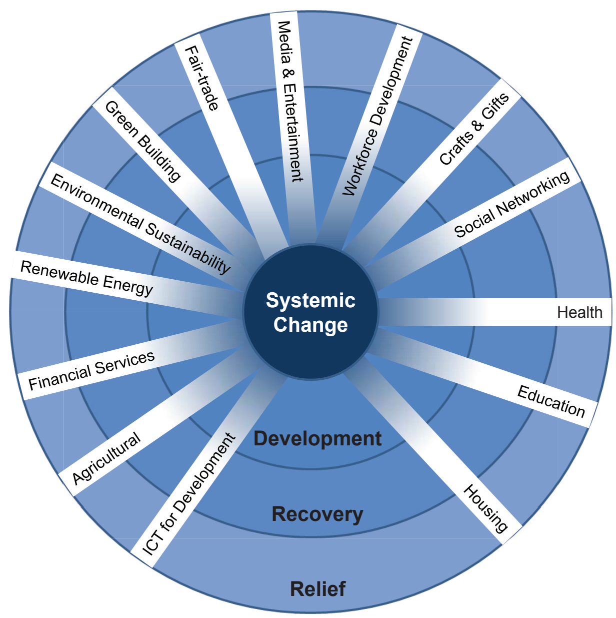
Together we face a new financial frontier.

MAPPING SOCIAL IMPACT

*Defining the Social Impact Landscape

The discussion of financial risk-reward tradeoffs in the social capital markets is significantly facilitated by the conventions of traditional capital markets. In the traditional capital markets, there are credit ratings, stock prices and other measures which allow investors to describe their risk and reward targets in a common language. The social capital markets can extrapolate or adjust traditional models and concepts from for-profit brethren – below market rate loans, for example. And since the final measure of making or losing money is the same in the social capital and the traditional capital markets, the leap is not that great.

Talking about and measuring the social impact component of social investing is more challenging. From the social impact perspective, the closest equivalent financial instrument to a social investment is grant funding. Unfortunately, there is not yet a set of clear and commonly-accepted metrics which capture the success and quality of social programs supported by grants. The social sector has deeply engaged in discussions of inputs, outputs, outcomes and impacts. Some program areas such as workforce development have long led the way in trying to monetize the value created by their programs. Groundbreaking social investors such as the **Acumen Fund** are developing measurement products for their own use -- like the recently announced **Portfolio Data Management System** -- and sharing them with the field. But still there is no widely accepted approach to measuring social impact – neither a concept nor specific metrics.



Seizing the opportunity **SOCAP08** offers by bringing together so many stakeholders in the social investment space, we would like to present a conceptual frame for describing social impact. With the Social Impact Landscape below we have attempted to suggest that regardless of the specific intervention – agriculture, social networks, education – we work across the same plane of social impact. We also suggest that social impact is not homogenous and that our interventions occur across a range of types of social impact – relief, recovery, development and systemic change.

Defining social value or social impact is challenging for a variety of reasons: the timeframe in which results should be evaluated can be lengthy, it is difficult to control for multiple contributing factors and claim credit for good results, the goals are lofty and hard to measure. Another reason which is discussed less often is that the social impact can be judged from two very different vantage points -- the perspective of the social investor or the perspective of the beneficiary.

The investor is usually in the better position to think about metrics and reporting and so controls how the benefit is measured. The beneficiary is often voiceless or pre-occupied with the simple realities to survival and has no time to spare on discussions of outcomes/outputs/impacts/etc. Rarely is the social impact considered from both perspectives.

Another complication to the measurement of social impact is that the investor can receive a warm and fuzzy feeling plus any tax benefit related to a qualified contribution or program-related investment regardless of whether the investment yields value to society. The reverse is also true, the experience of making the social investment can be entirely unsatisfactory to the investor -- no fun and no financial return -- while ultimately being valuable and life-enhancing to the beneficiary. Add on top of this the role personal preferences play. Depending on the social investor's personal opinion, social impact takes on an all or nothing veneer. Save the whales? Worthless. Save the Elgin Marbles? Priceless.

To assist in the challenge of capturing social impact, we start by suggesting that social impact falls along a spectrum – from relief to recovery to development to systemic change. We are not drawing a hierarchy among these four types of social impact. If the relief aid isn't provided in a timely and effective manner, then the community won't be intact for recovery, development or systemic change efforts. All of these types of social impact are necessary and important. But the scope and reach of each type of social impact is different.

TAXONOMY OF SOCIAL IMPACT

*Defining Social Value

	RELIEF	RECOVERY	DEVELOPMENT	SYSTEMIC CHANGE
DEFINED AS	response to a natural disaster or human security crisis	returning communities to normalcy or to a minimum-acceptable standard for daily living	improvements and opportunities which ensure the long-term health and happiness of communities	change which addresses the root causes of poverty and social exclusion by fundamentally altering society
RISK	execution risk	execution risk, opportunity cost	execution risk, political will	discovery risk, political will
EXAMPLES	soup kitchens, domestic abuse hotlines, refugee camps	literacy programs, living wage employment, access to potable water and fuel near to home	open space preservation, arts & culture, orphaned disease research and development	Examples: abolishment of slavery, mapping the genome, launch of the World Wide Web
STAKEHOLDERS INCLUDE	American Red Cross, Glide Foundation, International Rescue Committee	Teach for America, Pacific Community Ventures, World Neighbors	The Nature Conservancy, The Global Fund, American Conservatory Theater	civil society, courageous leaders, social entrepreneurs and changemakers

Just as there is a difference between the painkiller which alleviates the discomfort associated with an illness, the antibiotic which helps cures the underlying illness, and the vaccine which prevents contraction of the illness, there is a difference among types of social impact. Sometimes you just need the painkiller, but ultimately it would be great never to get sick in the first place.

We also suggest that just as there is financial risk there is an acceptable level of impact risk which corresponds with each potential level of social impact reward. Like risk-adjusted financial return, we believe there is risk-adjusted social impact. For social impact which is generated through service delivery (relief work and some elements of recovery), the appropriate level of risk is execution risk. The action is discrete, replicable and scalable as long as resources are unlimited. Bring food, water and shelter to the residents of New Orleans after the hurricane. It's the implementation that can either excel or breakdown.

At the other end of the spectrum, where the impact is a paradigm shift, there is the risk that the discovery will be overlooked or delayed (for technology solutions) or that the political will won't be strong enough (for leaps forward in areas like human rights). What's at risk is not the loss of capital but an opportunity cost related to safety, health, happiness and freedom.

If there is a Red Line of social impact it is **do no harm**. If there is a Blue Line, it is **risk-adjusted social impact**.

The difficulty is that the social investor will never be "held accountable" for generating sufficient impact for the risk taken. And who takes the risk? When thinking about examples of mitigating risks related to generating social impact – coverage ratios and high interest rates for micro-loans for example -- it's difficult to see if the risk is simply being off-loaded by the social investor to some other stakeholder, perhaps someone more vulnerable.

IMPLICATIONS FOR INVESTING WITHIN A SOCIAL CAPITAL MARKETS FRAMEWORK

*Why participate in the social capital market?

Beyond Triple Bottom Lines: Many investors who are new to the social capital marketplace assume that they can simple layer an additional social return matrix on top of the traditional risk return profile. Such an approach, however, at the very least may be problematic and shortsighted at best. **Specifically:**

» Since investors cannot assume that on average, greater risk will result in higher returns, might those who hold on to outdated assumptions become disillusioned and abandon this market.
» Equally important, by being boxed into conventional risk return constructs, investors may fail to recognize or pass over investment opportunities with profound social value creation.

Market Segments:
What is important to acknowledge in this discussion, is that overtime, there are effectively what we can consider today to be 'investment grade' opportunities in given social market segments. For example, in areas like low-income housing, microfinance and alternative energy, there are an emerging class of investments that in fact are demonstrating robust financial returns that would appear to offer consistent risk-return profiles. With that said, the mystery still remains.

Even in proven sectors, such as the environment, affordable housing or microfinance **the high performance of some players cannot necessarily be generalized across the sector all together**, While some MFIs offer competitive financial returns, many do not. Investors hit it out of the park when they invested in the Mexican, **MFI Compartamos**. But with 10,000 MFIs around the globe, there remain thousands that are undercapitalized, have not attained sustainability, and are hamstrung by erratic government guidelines.

It is very difficult to determine **which sector will move on to become investment ready and which will not**. Has fair trade reached that distinction (perhaps fair trade coffee yes, but fair trade crafts, no.)? Charter school financing? Workforce intermediaries? When do we know when a sector is more likely to offer consistent financial performance?

Investment Layers:
What we do know is that some of the most successful transactions, bring together different slices of capital, each with different risk return requirements and all participating in the same deal at the same time.

For example, many low-income housing or new markets projects may generate attractive returns for some investors – but these same projects typically rely upon layers of public subsidy and/or the participation of social investors whose softer priced capital allows the transaction to pencil cashflow positive.

Many of today's attractive microfinance opportunities, relied upon grant-funded institution and market building efforts in prior years. In fact, today's market rate opportunities were largely enabled through public subsidy.

QUESTIONS REMAIN

*A Continuing Discussion

We hoped to spark a discussion with this paper. We ask conference participants to help develop – or disprove – the ideas briefly raised here. The following questions may help shape such a discussion.

» Do risk, return and social impact all fit on the same plane?

» If risk is not homogenous -- and financial risk is distinguishable from social impact risk – what is the relationship between these two types of risk?

» Does social impact always tax financial profits? Can we identify examples where that is not the case?

» Is it possible to reach a shared definition of social impact? Or is this always an individual prerogative?

» When considering social impact, is there a hierarchy of virtue? If systemic change creates lasting results and creates multipliers, is this always superior?

» Can investors successfully come together to co-finance without a shared definition of risk-adjusted return? Of risk-adjusted social impact?

CONCLUSION

*A Guide to Further Conversation and Mutual Discovery

While energized by the potential of harnessing enterprise models to achieve sustainable, scalable approaches to social and economic problems, there remains considerable uncertainty. We can envision whole domains and knowledge that will be forged through experience – and in other instances we don't even know what we don't yet know. As we map this new social capital market and develop vocabulary and tools of the trade, new benchmarks and standards, collaboration and transparency will be a paramount concern. No one investor can build this market on their own.

That's why we are presenting this paper at a conference that is bringing together record numbers of social venture funds, along with relevant foundations, development agencies and angel investors, wealth managers and entrepreneurs. It's an attempt to help the gathered community make sense of this field that is part asset class, part movement, that mixes the power of the market with a social and environmental mission. That's why we are going to project our landscape on the wall to let people put themselves on the map, and why on the third day of the conference, we're going to convene a session where we let the community redraw the map itself.

Markets convene in conversations, not in taxonomies or on trading floors. This paper is not a conclusion as much as a guide to further conversation and mutual discovery.