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Please cite this paper as:

Wilson, K. (2014-07-01), "New Investment Approaches for Addressing Social and Economic Challenges", *OECD Science, Technology and Industry Policy Papers*, No. 15, OECD Publishing, Paris.
http://dx.doi.org/10.1787/5jz2bz8g00jj-en

OECD Science, Technology and Industry Policy Papers No. 15

# New Investment Approaches for Addressing Social and Economic Challenges

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OECD

**NEW INVESTMENT APPROACHES FOR ADDRESSING SOCIAL AND ECONOMIC CHALLENGES**

## FOREWORD

This paper aims to provide an introduction and overview about the social investment market for OECD member countries. Social investment is becoming increasingly important as a way to address both social and economic challenges. Several OECD member countries have been active in creating policies and support mechanisms for social investment. This paper seeks to provide background information on social investment, demonstrate how the market is evolving and highlight the role that policy makers can play in facilitating the development of the market.

This paper was written by Karen E. Wilson of the Structural Policy Division of the OECD Directorate for Science, Technology and Industry. The paper was approved by the OECD Committee on Industry, Innovation and Entrepreneurship (CIIE) in June 2014.

The OECD wishes to thank the Bertelsmann Foundation for their generous support of this work.

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## 1. Executive Summary

Social investment is the provision of finance to organisations with the explicit expectation of a social, as well as financial, return. Social investment has become increasingly relevant in today's economic environment as social challenges have mounted while public funds in many countries are under pressure. New investment approaches are needed for addressing social and economic challenges, including new models of public and private partnership which can fund, deliver and scale innovative solutions from the ground up.

Social investment involves private investment that contributes to the public benefit. This ranges from "impact-first" investors who are willing to provide funding for organizations that are not able to generate market returns to "financial-first" investors who are more traditional investors but with an interest in also having a social impact. A growing number of high net worth individuals, family offices, foundations and institutional investors have become interested in finding investments that deliver both a social and a financial return. Financial goals can range from capital preservation to a market rate of return. Social goals can include improving socio-economic, social or environmental conditions.

The market is evolving in various ways across countries. This is influenced by the differences in the country context and, in particular, the ways in which social and financial systems are structured which determines the role and mix of public and private capital. Several G8 countries, most notably the United Kingdom and the United States, have been active in creating new social investment models while interest and activity is emerging in other countries as well. These initiatives, led by governments, foundations, investors and other stakeholders, have helped accelerate the market in the past few years.

Social investment, or impact investment as it is now more often called, has evolved over the past decade as the result of a number of factors, including a growing interest by individual and institutional investors in tackling social issues at the local, national or global level. The recent economic crisis has further highlighted the tremendous social and economic challenges facing countries across the globe. Governments are seeking more effective ways to address these growing challenges and recognizing that private sector models can provide new innovative approaches.

The growth of social enterprises over the past several decades has also contributed to the emergence of social investment. Social enterprises seek to develop innovative ways to tackle social challenges through market mechanisms. These organisations need capital to grow but often face greater obstacles than mainstream firms. In response, a social investment market has grown over the past decade to address these needs as well as to develop additional approaches for financing solutions to social issues.

New financing models are emerging at multiple levels and in parallel to traditional markets. A growing range of social investment instruments have been developed, all with a different financial/social return profile. As in traditional finance, social investment instruments can include grants, loans, guarantees, quasi-equity, bonds and equity. Critical areas in which social enterprises and investors engage can include financial services, energy, healthcare, "at risk" populations, education, housing, food and agriculture. However, more financial products are needed in the market to meet specific needs of social enterprises as well as to attract a greater range of investors.

Social investments often need to be accompanied by technical assistance for social enterprises which is typically funded through grants. This catalytic capital is often provided by the philanthropic community or government. The technical assistances can include helping social entrepreneurs become investor ready, structure the appropriate financing and develop plans to scale their business models. Therefore both public and philanthropic support continues to be important for the development of the market.

"Pay for Success" instruments such as Social Impact Bonds (SIBs), first launched in the United Kingdom a few years ago, are capturing attention within the industry as well as in the broader public as an innovative new way to finance solutions to social issues. These models are spreading to other countries and have also led to the creation of the concept of Development Impact Bonds (DIBs) in emerging markets. These public-private partnership models are contributing to a much needed redefining of financing models.

Despite the evolution of the market, several challenges remain. These include a lack of products and capital across the full risk/return spectrum, a shortage of intermediaries and a scarcity of high quality investment opportunities into which larger amounts of capital can be deployed. Transaction costs in social investment remain high due to fragmented demand and supply and the complexity of deal structuring.

As in the mainstream financial markets, there are information asymmetries between investors and investees. These asymmetries are further compounded by the lack of commonly accepted standards for measuring social investment, confusion of terminology and lack of information about both existing investment provision as well as related government policy. There is also imperfect competition in the market due to high transaction costs as well as the lack of brokers, advisors, exchanges and other market mechanisms.

Other market failures include externalities and the absence of incentives to invest in sectors with public good properties. The social returns generated from social investments are primarily external to both the investor and the investee as the social aims are typically targeted to certain groups or society as a whole. Given the market inefficiencies, these externalities are not priced into social investment transactions. Social investment leverages the private markets to provide public goods, however, the mechanisms to do so are not efficient and therefore can benefit from government intervention.

The public sector can play a catalytic role in the social investment market in terms of creating a conducive regulatory environment, encouraging greater transparency and taking concrete steps to help develop the market. These actions can be taken at the international, national or local level. However, actions initiated in one country or region may not be appropriate for another – policy objectives, experience and local context must be taken into account.

The growing interest in social investment has also increased expectations. Can social investment deliver on the expected social and financial returns? Given the current lack of data and metrics for measuring social impact, it is difficult to prove. Clearer definitions and better data collection are needed to assess the current state of the market. Meanwhile, current collaborations on the development of common global standards for measuring impact can play a significant role in the further development of the market.

The social investment market remains small relative to traditional markets however it is growing in visibility and importance. Some say that the market is at an important inflection point, balancing between the efforts to attract mainstream investors and the need to generate greater social impact. In either case, the key in the coming years will be for market players to be able to demonstrate results.

## 2. Background

In January 2013, the Bertelsmann Foundation provided a voluntary contribution to the OECD for work focused on social investment in selected OECD countries. The goal of this work was to introduce the topic of social impact investment to OECD member countries, through the Committee for Industry, Innovation and Entrepreneurship (CIIE) in the Science, Technology and Industry Directorate. The member country representatives to CIIE are typically from Ministries of Economy. This was important in terms of raising broader awareness about the economic and social impact of this evolving form of finance.

The joint OECD-Bertelsmann Foundation initiative focused on the role of social investment in the context of changing financial systems. It included a joint roundtable, hosted by the Bertelsmann Foundation at their conference centre in Berlin on 2-3 May 2013. Attendees included policy makers, social investors (foundations, venture philanthropists and others), key intermediaries and other private sector investors in the social investment ecosystem.

The roundtable built upon the results of the Bertelsmann Foundation "Social Investing in Germany" workshop held in June 2012, expanding the view from Germany and the United Kingdom to other OECD countries. The Bertelsmann Foundation workshop focused on how capital from outside the public sector could be mobilized to drive social change on a sustainable basis.

The findings from the joint OECD-Bertelsmann Foundation roundtable in Berlin have been combined with further research and interviews resulting in this paper. For a list of those who have contributed to the work through the roundtable and interviews, please see Annex I.

Social investment is one of the focus areas of the Bertelsmann Foundation. It is also a growing area of interest within the OECD including within the Science, Technology and Industry Directorate, as part of the growing focus on innovation for inclusive development and new approaches to economic challenges. Research on social investment expands upon the work that CIIE has done over the past several years on entrepreneurship and financing, by exploring new models for financing solutions to social and economic challenges.

This issue has become increasingly relevant in today's economic environment and interest in social investment has grown considerably across several OECD countries including the G8 and G20. In the context of the UK's G8 presidency in 2013, Prime Minister David Cameron hosted a G8 Social Impact Investment Forum in London in June 2013 (HM Government, 2013c). The Forum was attended by ministers and other policy, business and civil society leaders from across the G8 countries. The event provided an opportunity to launch processes and initiatives to facilitate the development of the market on a global scale.

As one of the outcomes of the G8 Social Impact Investment Forum, the OECD was asked to produce a Global Social Impact Investment Report. The report will provide a framework for identifying and scoping the key components of the evolving social investment field on a global basis. That work, supported by a number of G8 countries, will build upon existing work at the OECD including the research on social investment conducted with support from the Bertelsmann Foundation. The project is being conducted in collaboration with other Directorates across the OECD whose work touches upon related topics.

The field of social investment is expanding rapidly with a growing number of players entering the market, yet there is not yet enough knowledge and evidence about these activities. This initiative is therefore very timely and will help inform the OECD member countries about developments in this area and the potential role of policy. The OECD is extremely grateful to the Bertelsmann Foundation for their collaboration and support of this initiative.

## 3. Social Investment

There are many terms and definitions used for social investment – ranging from socially responsible investing to impact investing and a great deal of confusion in the market (Brown and Swersky, 2012). The term "impact investing" was coined in 2007 through an initiative coordinated by the Rockefeller Foundation in the United States and its use has spread more widely since then.

According to the Global Impact Investing Network (GIIN), impact investments are defined as investments made into companies, organizations, and funds with the intention to generate social and

environmental impact alongside a financial return. Impact investments can be made in both emerging and developed markets, and target a range of returns from below market to market rate, depending upon the circumstances. GIIN further specifies that impact investments should have the following four core characteristics: i) intentionality; ii) investment with return expectations; iii) range of return expectations and asset classes; and iv) impact measurement.

In Europe, the term social investment is still more commonly used. Social investment is commonly defined as the provision of finance to organisations with the explicit expectation of a social as well as a financial return provided through a range of financial products ranging from debt to equity (Brown and Swersky, 2012). According to a BCG and Young Foundation paper in 2011, the key criteria of social investment should be that social returns are clearly defined *a priori* and are not an incidental side effect of a commercial deal and that the investor expects a financial return of at least a repayment of capital (Brown and Norman, 2011).

Most recently, the UK Cabinet Office has begun using the term social impact investment, defined as the use of finance to tackle entrenched social issues (HM Government 2013c). For the market to progress globally, it will be important for definitions to be clarified to make sure that there is a common language and understanding. However, at this early stage of development in the market, many players seem to prefer to keep the definitions broad.

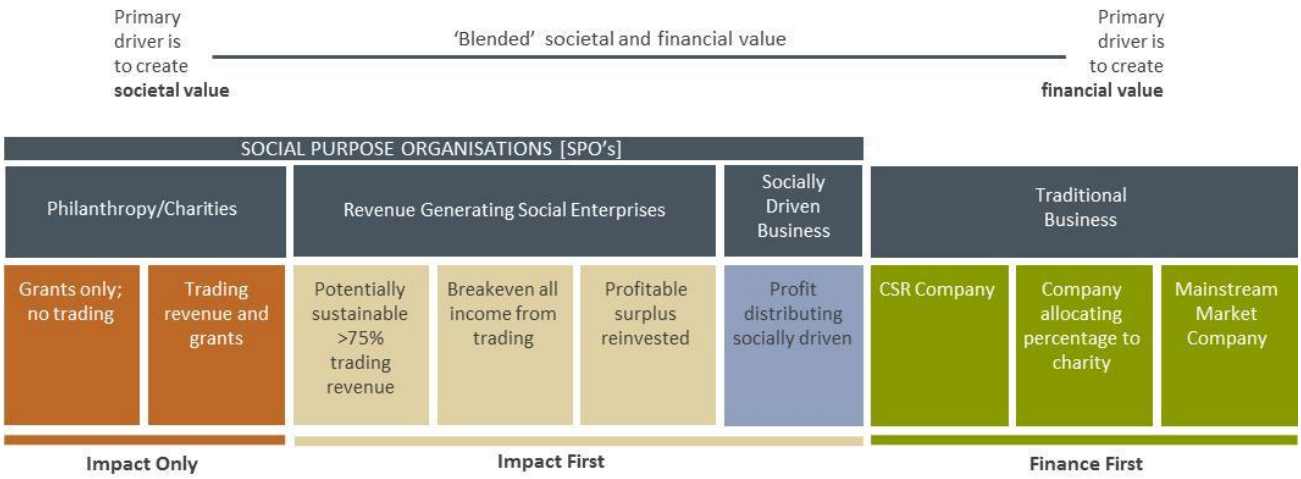
### *3.1 The Investment Spectrum*

Social investment involves private investment that contributes to the public benefit. Earlier descriptions of the market framed it in terms of spectrum, ranging from “impact-first” investors who are willing to provide funding for organizations that are not able to generate market returns to “financial-first” investors who are more traditional investors but with an interest in “responsible investing” (Freireich and Fulton, 2009; EVPA 2011, Bridges Ventures, 2012).

As first outlined in a 2009 Monitor Institute report, “Impact first” investors seek to optimize social or environmental impact with a secondary goal of financial return. These investors primarily aim to generate social or environmental good, and are often willing to give up some financial return, ranging from repayment of principal to market rate (Rangan et al., 2011). Impact first investors typically experiment with diversifying their social change approach, seeking to harness market mechanisms to create maximum impact (Freireich and Fulton, 2009).

“Financial first” investors seek to optimize financial returns with a secondary goal of social or environmental impact. They are typically commercial investors who are obligated to seek market rate returns (Rangan et al., 2011). They typically seek out subsectors that offer market-rate returns while achieving some social or environmental good. They may do this by integrating social and environmental value drivers into investment decisions, by looking for returns in a way that leads them to create some social value, or in response to regulations or tax policy (Freireich and Fulton, 2009).

**Figure 1. The Investment Spectrum**




*Source*: Adapted from EVPA (2011).

Traditional thinking was that pursuing social or environmental objectives could require some financial trade-off, although necessarily a financial loss. As experience in the market developed, a growing number of examples demonstrated that, in certain areas, social investments can generate both a solid financial and social return. It is in these areas that social investors can play a role in providing private capital to address social challenges in innovative new ways.

Social investments can be made across geographies, sectors, and asset classes and therefore have a wide range of return expectations. Often these investments are made with multiple types of investors providing capital. By combining various forms of capital with different return requirements, social and environmental challenges can be addressed in more scalable ways than possible by government alone (Rangan et al, 2011).

Impact first investors are willing to take more risk while finance first investors seek to meet their minimum return requirements. This also has implications in terms of the sectors in which each type of investor might choose to invest. Impact first investors seek market-based solutions to the world's most pressing challenges, including sustainable agriculture, affordable housing, affordable and accessible healthcare, clean technology, and financial services for the poor, while financial first investors typically gravitate towards more mainstream sectors which address social needs as well.

Grants, both public and private, continue to play an important role in the market especially given the fact that many social or environmental challenges do not have commercially-viable solutions (Bridges Ventures, 2012). Grants and technical assistance are often needed before or alongside social investment to help the social enterprises achieve the necessary level of investor readiness. While philanthropic grants are not considered social investment, foundations can and do engage in the market through market building activities as well as through mission-related or program-related investments (Rangan et al, 2011).

### *3.2 Social Investment Market Evolution*

Social investment began to emerge about a decade ago although there was significant activity prior to that (Saltuk et al, 2013). However, socially-conscious investing is not a new phenomenon and has origins dating back several centuries.

A number of decades ago, Socially Responsible Investing (SRI), a practice in which investors screen out companies with perceived negative products or practices, began to interest investors (Bridges Ventures, 2012). This later led to a broader group of "responsible" investors seeking socially responsible and sustainable investments (Addis et al, 2013).

Social investment has become increasingly relevant in today's economic environment as the global financial crisis has highlighted the need for long term value creation (Addis et al, 2013). New forms of both capital and enterprises are needed that can leverage market mechanisms to deliver measureable social impact (Rangan et al, 2011). Increasingly, experts suggest that social or environmental factors can impact a company's bottom line and therefore are important factors in business, markets and competition (Porter and Kramer, 2011).

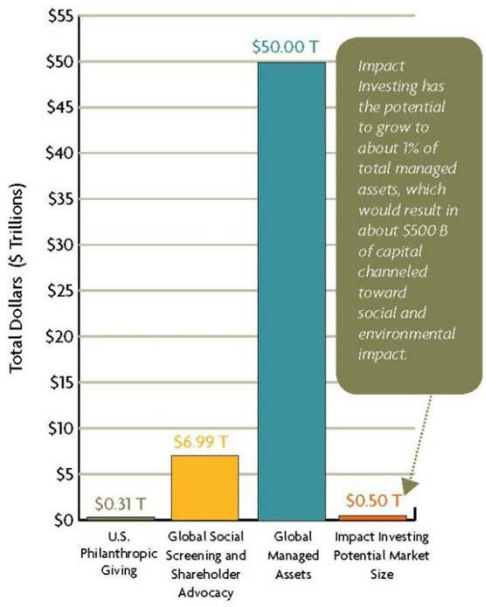
A number of OECD countries, such as the France, the United Kingdom and the United States, have played a leading role in developing the social investment market. There have also been significant developments and experiments in the past several years in many other developed and developing countries which are contributing to the development of new models and approaches.

While the social investment market has been growing significantly and has drawn increasing interest and attention, it is still in the early stages of development (Kohler et al, 2011) and is only a small share of the global capital markets today (Addis et al, 2013). Initiatives being led by governments, foundations, investors and others have helped accelerate the market in the past few years (Jackson and Associates, 2012).

While difficult to measure for a variety of reasons including the lack of clear definitions and the diversity of sectors and approaches across geographies, the social investment market potential is estimated to be tremendous. This is due to growing interest among foundations and mainstream investors as well as an intergenerational transfer of wealth, estimated at USD 41 trillion, which is expected to take place over the next 50 years with nearly USD 6 trillion of that expected to be directed towards social issues (Rangan et al, 2011).

In 2009, Monitor Institute estimated that the impact investing market could grow to USD 500 billion over the next 5-10 years if 1% of the estimated professionally managed global assets, based on 2008 figures, were applied to the market (Freireich and Fulton, 2009). To put that figure in perspective, the amount is almost double the current philanthropic giving in the United States (Rangan et al, 2011).

**Figure 2. Estimate of Comparative Market Sizes**

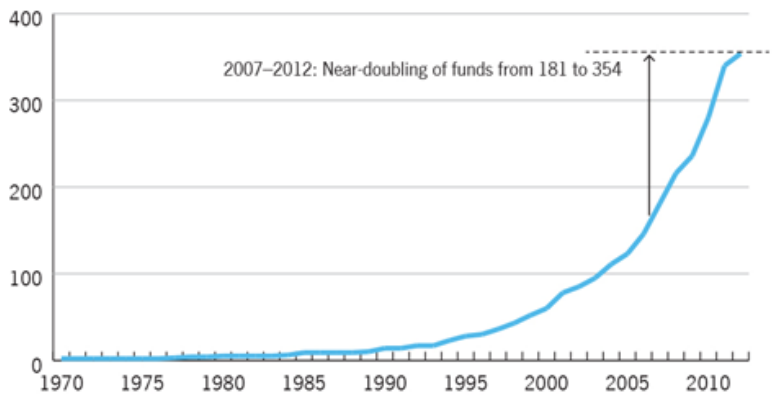



*Source*: Freireich and Fulton (2009).

In a study looking at five sub-sectors of 'bottom of the pyramid' businesses including urban housing, water for rural communities, maternal healthcare, primary education, and microfinance, J.P. Morgan projected the market potential to be between USD 400 billion to USD 1 trillion in the next 10 years with the most growth expected in housing and microfinance (O'Donohoe et al., 2010).

Looking at the market from another angle, growth can be seen in terms of the number of impact investing funds investing in a range of social enterprises. The chart below is from a study that shows the year of establishment of approximately 350 impact investment funds with a total capital of USD 40 billion. As shown in the figure, more than half of the funds were created in the past five years.

**Figure 3. Cumulative number of impact investment funds globally, 1970–2012**




*Source:* Clark et al. (2012).

JP Morgan and GIIN conduct an annual survey, which currently covers 125 impact investment funds. These groups committed USD 10.6 billion in 2013 and expect to increase that amount to USD 12.7 billion

in 2014, an increase of 19%. (Saltuk et al, 2014). In the previous year, from 2012 to 2013, committed capital grew by 10% and the number of deals increased by 20%. This compares to 2011, when the survey indicated that approximately 2 200 impact investments worth USD 4.3 billion were made (Saltuk et al, 2011). For an example of the distribution of the funds at that time, see Figure 4 below.

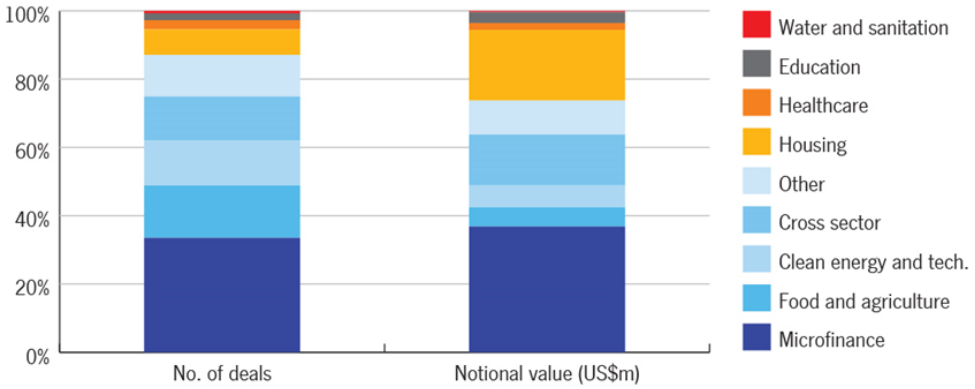
**Figure 4. Impact investing funds invested by destination during 2011**

*Source:* Saltuk et al. (2011).

The majority (80%) of the investment funds surveyed have headquarters in North America or Western/Northern/Southern Europe, however, the bulk of the assets under management are focused on emerging markets (70%) rather than developed countries (30%).

In terms of sectors, the current and the earlier surveys showed that microfinance remains the largest and most developed investment area in both number of deals and value. Housing is also a large investment area in terms of value. In some sectors, however, such as education and water and sanitation, it is difficult to build revenue models that recover investment (Rangan et al, 2011).

**Figure 5. Global funds investment by sector during 2011**

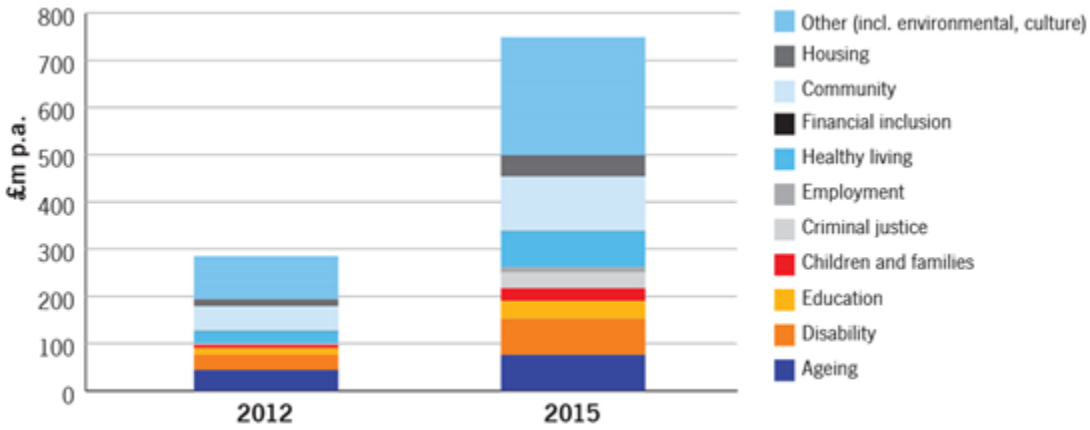



*Source*: Saltuk et al, 2011.

Looking further at social investment market potential and investment sectors, a study in England predicts a rapid growth in demand, an average of 38% per year, as a result of a number of trends. These

include growing outsourcing of public services to private and social providers; a new statutory requirement for commissioners to consider social value when awarding contracts; and a shift towards higher-risk models of payment, such as payment by results, that will encourage social organisations to favour social investment over mainstream investments (Brown and Swersky, 2012).

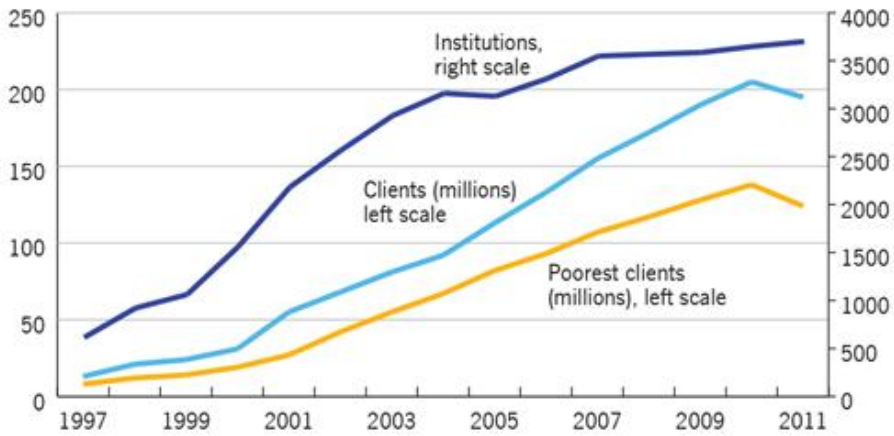
**Figure 6. Forecasted Growth in Social Investment Demand in England**




*Source:* Brown and Swersky (2012).

The growth of the microfinance industry is often referenced as a benchmark for potential growth in the broader social investment market. The microfinance market is estimated to be over USD 50 billion of loans given to over 100 million micro-entrepreneurs, mostly in developing countries (Rangan et al, 2011). From 1997-2007, microfinance grew at a rate of 38% per year in terms of the number of clients although growth has slowed in more recent years (Addis et al, 2013). The Monitor Institute and J.P. Morgan market growth estimates referenced earlier indicate similar possible annual growth rates for the impact investing market.

**Figure 7. Microfinance: clients and institutions globally, 1997–2011**




*Source*: Maes and Reed, *State of the Microcredit Summit Campaign Report,* Microcredit Summit Campaign, 2012.

Comparisons are also often made between social investment and the growth of the venture capital industry (Cohen and Sahlman, 2013). The venture capital industry, which was first created in 1946, grew over several decades through a series of United States government interventions, including legislation in the 1950s that allowed privately funded investment firms to provide capital to early-stage companies, ERISA in 1978 which enabled pension funds to invest in venture capital firms, and a lowering of the capital gains tax rate (Freireich and Fulton, 2009). In the 1970s, the industry began growing in Europe and later in other parts of the world. Pioneers in the venture capital industry included Sir Ronald Cohen, one of the leaders and key drivers of the social investment movement, in the United Kingdom and globally, and current Chairman of the Social Impact Investment Taskforce established by the G8 in 2013.

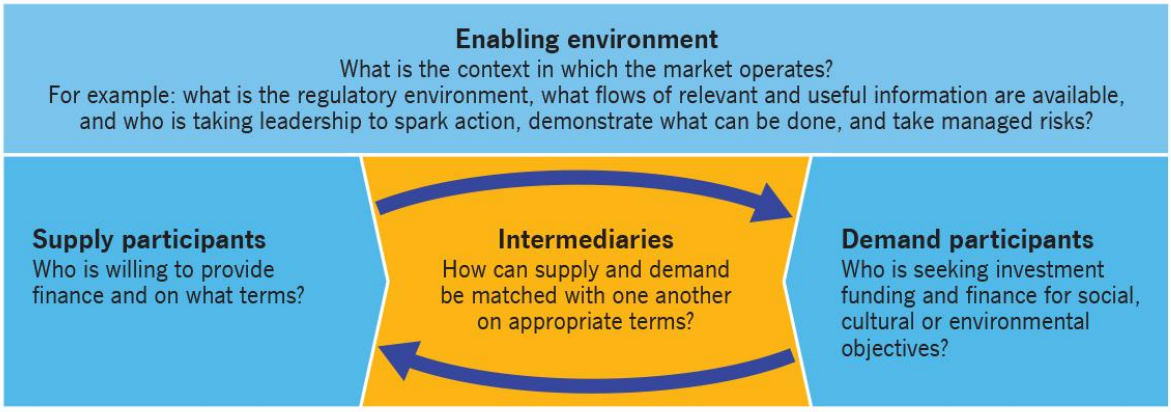
## 4. Overview of the Social Investment Ecosystem and Products

### *4.1 The Social Investment Ecosystem*

A growing range of actors are emerging to form an ecosystem consisting of investors, social enterprises and intermediaries. Government also plays a key role in the ecosystem, both in terms of setting conditions for the enabling environment as well as acting as a catalyst in the development of the market.

Progress in the social investment market will depend on a multiplicity of stakeholders working together to build critical mass by developing the market, tools and practices. Those stakeholders include investors, investees and intermediaries as well as policy makers, all with varying interests and motivations. Building trust and transparency is therefore important.

**Figure 8. The Social Investment Market**




*Source*: Addis et al, 2013 (adapted from Freireich and Fulton, 2009 in collaboration with Effective Consulting and the Australian Government Department of Education, Employment and Workplace Relations).

While the social investment market is evolving rapidly, it is currently very fragmented. Experiments have not yet become scalable models. Further experience sharing between players in the market can be important in developing the market and highlights the important role that the process initiated by the United Kingdom in 2013 under the Presidency of the G8[1]. In addition to the international Social Impact Investment Taskforce that was established in mid-2013 and that has been meeting every two months, National Advisory Boards have been established to encourage collaboration between market players within each country.

[1] https://www.gov.uk/government/groups/social-impact-investment-taskforce.

*4.1.1 Supply side*

There are an increasing number of investors looking to place capital in social ventures. These include charitable foundations, high net worth individuals and philanthropists, banks and other financial services firms and intermediaries. To date, the most active social investors have been high net worth individuals (HNWI) and family offices, who have more flexibility and autonomy than other investors (WEF, 2013). Some high net worth individuals invest through angel groups focused on social impact investment (OECD, 2011), a growing area of interest for angel investors.

Foundations have played a critical role in the development of the social investment market (Koh et al., 2012). This role has ranged from building market infrastructure to being social investors themselves. By making investments alongside grant making, foundations are able to leverage their assets more efficiently to achieve their social mission (HM Government, 2013a). According the recent J.P. Morgan and GIIN survey, program-related investments allow foundations to use indicated "more appropriate tools for achieving programmatic objectives in certain instances" and "access to additional vehicles through which impact can be delivered (e.g. investment funds)" (Saltuk et al, 2014).

Foundations have the advantage of being independent from government and the markets and therefore are in a position to take on greater risk and provide long-term 'patient' capital. This gives them the freedom to explore and create innovative ways to address social, economic and environmental challenges. Development Finance Institutions (DFIs) have also played an important role in the market by being first lost or "catalytic" funders (GIIN, 2013).

Some pension funds, insurance companies and other institutional investors have also entered this market (Wood et al, 2012). However, these mainstream investors tend to focus on investments with at least a market risk adjusted financial return due to fiduciary responsibilities (WEF, 2013). At the same time, other private firms, such as investment banks, private banks and private equity funds are exploring areas in which they can provide capital to profitably grow businesses in various social sectors.

In addition, the public sector has played an important role through central government departments, local authorities and other government agencies. This has included various forms of direct and indirect support. Increasingly, individual citizens are also increasingly able to participate, whether through investments in the local community or through pension funds with a social return element. Crowdfunding platforms increasingly are also providing access.

*4.1.2. Demand side*

While the focus of this paper is on developments in social investment, it is important to highlight that the goal of the financing is to support and grow social ventures. These demand-side actors seek to find new models to deliver social impact and create new markets through their social ventures (HM Government 2012).

The term "social enterprise" began gaining visibility in the 1990s as an innovative business model for meeting social and economic objectives, however, the organisational structures and legal forms vary widely across countries (OECD, 2009). These organisations can include community organizations, charities or not profits, social enterprises and social businesses. In some countries, only non-profit organisations could be consider "social" however rules are changing to include for-profits with a social purpose. Legal structures are discussed further in section 4.1.3.

The challenges for social enterprises are parallel to those for high growth firms, including how to address real problems with innovative solutions and how to maximize growth and impact. A recent survey showed that business model execution and management is seen by investors at the highest risk to their

investments in social ventures (Saltuk et al, 2014). Some ventures will (and should) fail. The reasons for failure vary from management, strategy or funding to regulatory and administrative barriers. A recent report in the U.S. showed that social enterprises do better and fail less than for-profits because they are built on real problems and (unfortunately) the market is there and growing.

Social investors can help social enterprises by providing not only financing but perhaps more importantly, support on strategy, management and growth (Bannick and Goldman, 2012). Helping social entrepreneurs grow their ventures to scale is the key to maximizing impact (Koh et al., 2012). The success of social investment is reliant on the long term sustainability and performance, both social and financial, of the social enterprises in which the investments are made (Bannik and Goldman, 2012).

Investor readiness remains a key issue for social enterprises in many countries. Support with investor readiness and business capability, as described above, can be more important to the social entrepreneur than the actual finance (HM Government, 2011). Social enterprises can also face challenges in a number of other areas including finding adequate legal forms or conforming to impact assessment standards. As the focus on impact measure has increased, so have the pressures on social enterprises to compile with a varying set of standards, many of which can be time consuming and do not always feed back into the management and objective setting processes within the organisation. Efforts are being made to develop a streamlined set of reporting standards (see section 6.2).

*4.1.3. Intermediaries*

Intermediaries can play a pivotal role in developing the social investment ecosystem. They provide the links between investors, investees and others in the social investment market and provide innovative new solutions to improving efficiencies in the market. They play functions such as creating liquidity in the market and facilitating payment mechanisms which can also help to lower costs and reduce risks in the market (WEF 2013). Intermediaries can include commercial banks, investment banks, independent financial advisors, brokers, dealers, and exchanges.

As highlighted in the 2009 Monitor Institute report, market building activities are important. To build the market, collaboration is crucial for ensuring that the roles of the various players are complementary (HM Government, 2013c). Trust and open communication is importance for the process of market building. This provides the basis for the creation of new innovative models, which can be tested in a continual process of development and growth of the market.

In the United Kingdom, Big Society Capital (BSC) acts as a wholesale investor for social investment by investing in intermediaries and championing the sector to the public, stakeholders and investors. BSC has also commissioned a number of research reports on the social investment market and created guides and standards for investors and social enterprises (Addis et al, 2013).

However, in most countries, intermediaries either do not exist or are not present at a sufficient level. Intermediaries and advisors are hard to finance due to high operating costs. Currently, most survive through donations. Others take transaction fees or a piece of equity. Policy makers, foundations and others can play a role in the early stages of building the market but need to identify ways that the intermediaries can be sustainable in their own right over time.

**Box 1. Big Society Capital (BSC)**

Big Society Capital (BSC) is an independent financial institution in the United Kingdom established to develop and shape a sustainable social investment market in which social sector organisations can access the capital they need to increase their positive impact on society. BSC was launched in April 2012 and is the first social investment bank in the world.

BSC is a 'social investment wholesaler' which provides finance to social investment finance intermediaries (SIFIs). These are organisations that provide appropriate and affordable finance and support to frontline charities, social enterprises and voluntary organisations (the social sector). BSC seeks to achieve its objectives by addressing key market failures in the social investment market, ultimately increasing the social impact achieved by frontline social sector organisations.

The five key areas of activity include supporting or providing: capitalisation and balance sheet growth; risk and working capital; sustainability and organisational growth; market mechanisms and infrastructure; advice, skills and information.

BSC was funded from GBP 400 million in dormant bank accounts and with GBP 200 million from the four major banks (Barclays, HSBC, Lloyds, and Royal Bank of Scotland). Most of BSC's GBP 600 million in capital is for investment in social finance investment intermediaries. BSC seeks to achieve financial sustainability over the long term.

*Source*: http://www.bigsocietycapital.com/.

In addition to developing intermediaries, existing "traditional" financial players can be encouraged to enter the market. A number of efforts are underway to do so, including through the Global Impact Investing Network (GIIN) which focuses on engaging traditional institutional investors into the social investment market.

**Box 2. Global Impact Investing Network (GIIN)**

The Global Impact Investing Network (GIIN) is a nonprofit organization dedicated to increasing the scale and effectiveness of impact investing. The GIIN was conceived in October 2007, when the Rockefeller Foundation gathered a small group of investors to discuss the needs of the emergent impact investing industry. In June 2008, a broader group of 40 investors from around the world met to discuss what it would take for the impact investing industry to be able to solve more social and environmental challenges with greater efficiency. Just over a year later, the GIIN was formally constituted as an independent organization.

The GIIN addresses systemic barriers to effective impact investing by building critical infrastructure and developing activities, education, and research that attract more investment capital to poverty alleviation and environmental solutions. Specific initiatives include outreach, network membership, the Investors Council, ImpactBase (an online global directory of impact investment vehicles) and IRIS.

Impact Reporting and Investment Standards (IRIS) is a set of metrics that can be used to describe an organization's social, environmental, and financial performance. IRIS is designed to address a major barrier to the growth of the impact investing industry - the lack of transparency, credibility, and consistency in how organizations and investors define, measure, and track their performance.

*Source*: http://www.thegiin.org.

Rating and certification agencies play an important role in the market (WEF 2013). The IRIS initiative, mentioned in the above box, aims to encourage the adoption of a standard format for reporting for social, environmental, and financial performance. The Global Impact Investing Ratings System (GIIRS) is a ratings agency and analytics platform for impact investors. GIIRS reviews, evaluates and

scores the social and environmental impact of companies and funds along a number of dimensions *of* social and environmental impact. Since it was launched in 2011, over 63 funds and 409 companies from 30 countries entered into the process of being GIIRS-rated. Impact measurement is discussed further in section 6.2.

#### *4.1.3 Enabling environment*

Many factors influence the development of the social impact investment market in a country. These include framework conditions, the regulatory environment, tax legislation and, in particular, the ways in which social and financial systems are structured.

The general framework conditions in a country can have a significant impact on the development of financial markets in general and the social investment market as well. There are several legal and regulatory issues that impact institutional investors including the new Solvency II (insurance companies) and Basel III (banks). In addition, the EU Structural and Investment Funds (EUSIF) initiative is meant to be helpful to the social investment market by creating lighter regulation but likely will create additional barriers as decisions on how each fund will be treated will be determined at the national or local level. The new legislation came into effect in the summer of 2013 and could have a negative impact on social venture funds.

Legal structures can also be an issue for social enterprises and investors as existing structures (either for-profit or non-profit) may restrict investments or flexibility in some countries. A number of new corporate structures are developing in various countries to meet the needs of hybrid social ventures. These hybrid corporate structures seek to blend for-profit and non-profit sources of funds to enable social organisations to pursue their mission (Rangan et al, 2011).

In the United States, laws have been passed in a growing number of states to create a new type of corporation, the Benefit Corporation. These B Corporations are required to certify to meet rigorous standards of social and environmental performance, accountability, and transparency. In the United Kingdom, the Community Interest Company (CIC) was established in 2005. It is a corporate structure which requires that the company's assets are locked to use for a community purpose. While other legal structures are being created in other states and countries, some market participants argue that existing structures are sufficient and that these new structures add more complexity in securing funding (Rangan et al, 2011).

### ***4.2 Social Investment Instruments, Funds and Exchanges***

The social investment market is developing in parallel to the current investment market in terms of products, funds and market structures. Typically, social investment entails the use of debt or equity instruments to deliver social or environment "return" as well as a financial return, depending on where the instrument lies on the spectrum as well as how well the investors and investees perform (Kramer and Cooch, 2006). New products and structures are continuing to be developed to meet the growing needs in the market (HM Government, 2013a).

#### *4.2.1 Social Investment Instruments*

There are a range of social investment instruments available today, all with a different financial/social return profile. A better understanding is needed about the range of social investment instruments available including when and how each might be deployed. In addition, further information would be useful about the financial and social performance of the various instruments in order to help investors better assess impact, risk and return (Jackson and Associates, 2012).

As in traditional finance, social investment instruments can include grants, loans, guarantees, quasi-equity, bonds and equity. However, more products, in the form of tailored financial instruments, are needed to match the various risk profiles and development stages of social ventures. Currently, there is a lack of a capital aggregation ladder (capital needed for social enterprises to grow and scale their business models) common to other asset classes.

While there are differences across countries, in general there is a shortage of risk capital available, at both the early stage as well as at the growth stages. The ecosystem needs to be able to take risks and have the capital to fund innovative ventures. In some countries there are still some legal complications for social equity investment but attempts are being made to solve it with quasi-equity and other instruments.

Today, most social investment is still in the form of grants, primarily from the philanthropic community, or secured loans. There is a need for hybrid models using a combination of instruments. Increasingly, foundations are co-mingling traditional grants with social investment funds to combine their own experience and assets with those of commercial investors (HM Government, 2013a). Most deals require a mix of different types of instruments and therefore do not fit a binary model of finance first versus impact first. Further analysis and sharing of practices on the appropriate mix of instruments would be useful.

Social Impact Bonds (SIBs), first launched in the United Kingdom a few years ago, are capturing attention within the industry and in the broader public. Social Impact Bonds (SIBs) are a way of tackling deep rooted social problems at scale and therefore can attract larger institutional investors. SIBs are "Pay for Success" contracts that are designed to increase funding for preventative services that improve social outcomes. The financial return is dependent on the degree to which outcomes improve. The first SIB was the Peterborough Prison Social Impact Bond launched in September 2010. It was created to decrease recidivism rates among short-sentenced prisoners.

**Box 3. Social Impact Bonds (SIBs)**

Social Impact Bonds (SIBs) are a form of an outcomes-based contract in which public sector commissioners commit to pay for significant improvement in social outcomes (such as a reduction in offending rates, or in the number of people being admitted to hospital) for a defined population.

SIBs are an innovative way of attracting new investment around such outcomes-based contracts that benefit individuals and communities. Through a Social Impact Bond, private investment is used to pay for interventions, which are delivered by service providers with a proven track record. Financial returns to investors are made by the public sector on the basis of improved social outcomes. If outcomes do not improve, then investors do not recover their investment.

SIBs provide up front funding for prevention and early intervention services and remove the risk that interventions do not deliver outcomes from the public sector. The public sector pays if (and only if) the intervention is successful. In this way, SIBs enable a re-allocation of risk between the two sectors.

*Source*: http://www.socialfinance.org.uk/work/sibs.

The SIB model has quickly spread across the United Kingdom and to other countries, including the United States, Australia and other countries. These SIBs focus on a range of social issues including, for example, criminal justice (United Kingdom, United States Australia), child/family support (United Kingdom, United States, Australia), homelessness (United Kingdom, United States), employment (United Kingdom, United States, Israel) and health (Israel, United Kingdom). These and many other new models are currently being developed in a growing number of countries. While the SIB model is an

innovative way to improve public service delivery, it can also be complex and time consuming to structure and implement (Addis et al, 2013).

An adaptation of the SIB model has been created for developing countries called Development Impact Bonds (DIBs). These are financial instruments that provide new sources of financing from private investors to improve development outcomes. Public sector entities, including the governments of developing countries and donors engaged in those countries, face similar societal problems to the ones that the SIB model tries to address in developed countries. DIBs therefore seek to improve the effectiveness of traditional donor-funded projects by shifting the focus on to implementation quality and the delivery of successful results by introducing private sector actors who may be better-positioned than the public sector to take on risks associated with innovation. Examples of DIBs currently under development include one focused on sleeping sickness in Uganda and another on malaria in Mozambique.

The results of these and other social investment instruments have yet to be seen, particularly as many of these are relatively new. While the experience to date on the Petersborough Prison SIB has been positive, the first formal evaluation of results will only take place starting in 2014.

*4.2.2 Social Investment Funds*

Mainstream investor interest is growing with some having dedicated social investment teams to invest in social investment funds. The number of social investment funds is increasing. Some of these funds are independent while others are affiliated with large banks or development institutions. Funds might focus on certain sectors, geographies or investment stages. They typically target market returns investing through a mix of grants, subsidized loans and equity investments. More recently, fund-of-funds have been created to provide greater scale and diversity for institutional investors (WEF, 2013).

*4.2.3 Social Venture Funds*

Social venture funds started over a decade ago and are becoming more prevalent, however most are young, small, first time funds without a track record, making it difficult to attract institutional investors (GHK, 2013). These typically followed a venture capital type of model but can include a mix of instruments beyond equity. Like venture capital funds, social venture funds take a portfolio approach to investing to balance risks and returns (Saltuk, 2012).

There are different types of funds with different risk/return expectations which can make it difficult to find investors for early stage social investments. Awareness about social ventures funds has been increasing (including recent media coverage) and deal flow is improving. However, there needs to be more education about the sector.

Social investment fund managers often have a close hands-on relationship with the social purpose organisation they support, driving innovative and scalable models of social change (EVPA, 2011). Some may take board seats at these organisations and most are more involved at the strategic and operational levels.

Models for these funds can vary. For example, Social Venture Fund (headquartered in Germany but expanding to other countries as well) invests in social enterprises, which have innovative and entrepreneurial driven solutions for urgent social and environmental challenges. Bridges Ventures (see Box 4 below) began by investing in for-profit ventures in underserved communities but also has created a Social Entrepreneurs Fund.

**Box 4. Bridges Ventures**

Bridges Ventures is a private investment firm, created in the United Kingdom in 2002, dedicated to using an impact-driven investment approach to create superior returns for both investors and society at-large. The firm currently has over GBP 300 million under management in Sustainable Growth Funds, the Bridges Sustainable Property Fund, CarePlaces Fund, the Bridges Social Entrepreneurs Fund and the Bridges Social Impact Bond Fund. All funds aim to achieve dedicated social and/or environmental goals as well as aiming to achieve financial returns for investors.

In 2009, the Bridges Social Entrepreneurs Fund was created which was the first UK-based fund dedicated to providing equity and equity-like growth capital to social enterprises. The fund was closed at GBP 11.75 million after receiving direct investments from foundations, corporates, high net worth individuals and the Cabinet Office. The Esmée Fairbairn Foundation was one of the fund's lead investors.

The fund has committed a total of GBP 7.2 million, of which GBP 3.5 million has been invested into nine social enterprises. Across the portfolio to date, the investees have supported 984 jobs and created 387 jobs, hired 284 formerly unemployed people and trained a total of 1 850 individuals.

*Source*: http://www.bridgesventures.com.

Some social investors are finding that investment needs to be focused in terms of sectors or "verticals" (Bannick and Goldman, 2012). This enables a concentration on building the necessary links within a specific sector and thinking about social businesses in the context of the sector ecosystem.

Social venture investors have challenges in assessing the growing number of projects. It requires systems, structures and processes. Mission drift can be a danger. It is important for there to be as much direct contact as possible between fund managers and the "front line" (i.e. to listen to people who are actually doing the work) to truly understand the operating model and key success factors. Until social enterprises get to scale they are very fragile and need lots of non-financial support. Social venture investors tend to stay invested and try to get the organizations to sustainability.

### *4.2.4 Venture Philanthropists*

Depending on their own mission and the social ventures they choose to support, venture philanthropists can operate across the spectrum of investment returns. Some offer non-returnable grants for a purely social return while others use loan, mezzanine or quasi-equity finance for blended risk-adjusted financial and social returns (EVPA, 2011).

Venture philanthropists provide substantial and sustained financial support to a limited number of organisations. Support typically lasts three to five years although it can also be longer. The goal is to help the organisation become financially self-sustaining by the end of the funding period (EVPA, 2011). Foundations have become increasingly interested in these models. A recent OECD publication highlights some foundation's experiences to date in developing countries (OECD, 2014).

### *4.2.5 Social Stock Exchanges*

Over the past several years, social stock exchanges have been developed in both OECD and non-OECD countries. These include Social Stock Exchange (SSE) in London, Nexii in South Africa, and Impact Investment Exchange (IIX) Asia in Singapore. These exchanges target smaller high growth enterprises in sectors such as health, education, environment, social and affordable housing, sustainable forestry and organic agriculture and other "base of the pyramid" interventions. Social stock exchanges seek to build a platform for social businesses to attract capital from individuals, private clients, family offices, foundations and institutional investors who are seeking both a social and a financial return.

These markets facilitate the purchase of stocks and bonds in companies that have both economic and social returns. These could be either non-profit or for-profit companies. For-profit companies can either issue shares representing ownership in their companies or issue bonds. Not-for-profit companies can utilise the stock exchange to issue bonds.

The London Social Stock Exchange was launched in 2013 with the aim to become an FSA-authorised and regulated investment exchange for trading in securities of social enterprises and other social purpose businesses (HM Government 2013a). Supported by the London Stock Exchange Group, the SSE already has a number of listed member companies.

The London SSE seeks to connect socially focused businesses with investors looking to generate social or environmental change as well as financial return from their investment. This is done by providing investors with information to identify and compare organisations that deliver value to society and the environment. The London SSE seeks to have a transparent, independent and rigorous admission process to ensure that the companies listed adhere to a clear set of values, standards and disclosures.

In 2006, the Stock Exchange of Mauritius (SEM) successfully launched the Development and Enterprise Market to support medium-sized and growing business in Mauritius. Building upon its experience and recognition by Africa Investor (Ai) as Africa's most innovative stock exchange in 2011 and 2012, the SEM partnered with Nexii to jointly develop the regulatory framework of Impact Exchange, collaboratively drafting listing rules that would cater towards impact investment opportunities.

Intermediaries/advisors pay an application fee as well as an annual membership fee, which allows them to become members of the exchange. The companies or organizations don't need to be profitable when they join as the rules allow a three year window to become profitable (but based on a clear plan to do so). They pay for advisors as well as for the application and listing fees. Rigorous reporting requirements are part of eligibility. Organizations can be delisted or suspended if they do not comply. Impact Exchange aims at becoming a platform for the public to invest in and trade shares of social enterprises while assuring mission alignment to social and/or environmental impact.

In Singapore, the IIX was developed to be Asia's first private and public platform for social enterprises (SEs) to raise capital. IIX received funding from ADB and has focused on capacity-building. It acts as an "impact incubator" for investments up to USD 100 000, collecting money through an introduction model. It serves as an "impact partner" for investments from USD 100 000 to USD 5 million.

In 2013, Nexii and IIX Asia agreed to collaborate to strengthen and standardize the impact investing sector. In May 2013, IIX took over the cooperative management of Impact Exchange with the Stock Exchange of Mauritius (SEM). Impact Exchange aims at being a social stock exchange with significant global reach, from Africa to Asia, two regions in need of capital assistance for sustainable development.

In the joint OECD/Bertelsmann Foundation roundtable in May 2013, it was noted that creating a social stock exchange is an expensive and long-term, market building venture. Social stock exchanges require a lot of grant money or public support to get up to speed and can take 5-7 years to get to sustainability through fees. Also, it requires building an entire system ("pipes and plumbing") which takes time.

There are many steps in the process ranging from working with regulators to verification of intermediaries, support of social enterprises in becoming investment ready and marketing to investors. Setting clear eligibility criteria for listings is very important. The benefits of social stock exchanges are that they can help create an impact measurement framework, raise awareness about social investment, attract funding and provide market signals to match investors preferences.

One of the most significant barriers to successful engagement in the social impact investment market is the lack of evidence and measurement of the social and environmental credentials of the businesses that they invest in. These social stock exchanges seek to address this gap by providing a single reference point for investors as well as standardised and comparable social impact disclosure.

In addition to these exchanges, other platforms exist such as the GIIN ImpactBase, which is a searchable database for accredited investors to find information about impact investment funds (WEF 2013).

## 5. Experiences in Selected OECD and non-OECD Countries

The market is evolving in various ways across OECD countries. This is influenced by the differences in the country context including history, socials needs and value systems. In addition, the ways in which social and financial systems are structured will determine the role and mix of public and private capital and therefore the potential role of social impact investment. Transparency about the role of the public sector versus other players and the process of collaboration is critical.

At the same time, definitions and understanding of the terms social investment, social finance, impact investing and social economy differ dramatically across and within countries making it difficult to compare developments across countries. Definition issues are particularly important when it comes to policy incentives and regulations (which organisations qualify and which do not). Welfare state models determine polices and attitudes across different countries and this has a significant impact on the market.

Given that countries are at different stages of development, the awareness raising and experience sharing process of the Social Impact Investment Taskforce established by the G8, and the associated National Advisory Boards in the G7 and Australia, has been helpful in moving the overall social impact investment market forward. These activities have helped spur additional action and attract new players to the market. In addition, social investment market champions within countries can play a useful role in spurring market growth (HM Government, 2013c).

In many of the countries highlighted below, there is capital, there are many social entrepreneurs and there are an increasing number of intermediaries. The challenge is to have more investable social enterprises, including ones that can grow and scale their business models. In addition, social investment often requires some technical assistance for the social entrepreneurs (including to become investor ready) which is expensive to provide and hard to fund. These costs are either incurred by social venture funds or by intermediaries but are not sustainable.

During the OECD/Bertelsmann Foundation Roundtable in May 2013, it was noted that there is a need to rethink the role of investments. Currently investments are thought about in buckets of traditional investors, social investors, philanthropists and the State. In reality, the actions of these different types of investors influence each other and need to be considered in a more comprehensive manner in terms of who should play which role to move the overall agenda ahead. To engage more mainstream investors, including institutional investors, will require framing the discussion in language they can relate to, not purely in "social investment" terms.

In many countries, there is struggle between financial and social return expectations. At the OECD/Bertelsmann Foundation roundtable it was suggested that it can be hard to have financial, social and environmental returns at the same time. It was noted that the "cheap – good – fast" model is indicative of this dilemma – it is possible to have two but rarely three of these components. It was suggested that key players in the industry need to be more vocal about return expectations to help clarify what is possible and

what is not. To that end, better documentation and clearer communication about social investment could be useful.

### *5.1 United Kingdom*

The United Kingdom social investment market is one of the most active ones. Many say that the journey of building the current United Kingdom social investment market began in the year 2000 with the UK Social Investment Task Force recommendations. That process stimulated discussions and led to a series of actions by the public, private and NGO sectors. Cross party political building cemented government support.

Community development finance organizations played a role and charity banks became more active. In addition, a shift occurred in terms of how charities were viewed, becoming seen as being strategic and important to government as service providers. The government created funds to help social enterprises win government contracts in an attempt to help them become more sustainable (i.e. less reliant on grants or subsidies).

Key individuals, such as Sir Ronald Cohen, provided leadership and vision helping to launch new initiatives and encourage experiments and innovation in the market. This included the creation of Bridges Ventures, Social Finance and Big Society Capital. The work of these organizations is referenced earlier in the paper, including Social Finance's creation of the Social Impact Bond (SIB) and the Development Impact Bond (DIB).

There are now over 14 SIBs in the United Kingdom with many more under development. More recently, SIBs have been created in Australia and the United States focused on addressing a variety of social needs such as, criminal justice, health, families, homelessness and employment (OECD, 2013). While these SIBs are based on the UK model, they are adapted for the local context. The UK Cabinet Office has established a Centre for Social Impact Bonds[2] that promotes the development of SIBs as well as experience sharing about models and approaches. They are taking the learnings from these experiences and feeding them back into the current thinking and development of the SIB market. SIBs are perhaps the most pure form of public private partnerships in this field and represent an opportunity to change the way government approaches social problems.

As discussed earlier, the Social Stock Exchange (SSE), based in London, was launched in June 2013 to connect publicly listed social impact businesses with investors seeking to generate positive impact alongside a financial return. The SSE is supported by the London Stock Exchange Group, City of London Corporation, Big Society Capital and the Rockefeller Foundation (HM Government, 2013c).

The UK government has played a key role in creating market infrastructure with the creation of BSC and the provision of tax incentives. There is leadership and support from government across the political spectrum to address these issues and grow the market. The Social Investment and Finance team within the UK Cabinet Office has listened and partnered with players in the social investment ecosystem to identify and address market gaps. This has resulted in the support and development of a broad set of initiatives geared towards further developing the market.

In the 2014 Budget, the UK Government announced a new social investment tax relief which will give individuals who invest in qualifying social organisations a reduction of 30% of that investment in their income tax bill for that year. The government's aim in introducing this new tax relief is to encourage

[2] https://www.gov.uk/social-impact-bonds.

private investment in social enterprise (HM Government, 2013c). In 2002, the Community Investment Tax Relief (CITR) scheme was devised to encourage private investment into Community Development Financial Institutions (CDFIs). The United Kingdom has several other tax incentive schemes for investments in higher-risk ventures (HM Government, 2013b), including the Enterprise Investment Scheme (EIS), the Seed Enterprise Investment Scheme (SEIS) and the Venture Capital Trust (VCT).

Recently, a relatively small (GBP 10 million) but strategic fund, the Investment Contract and Readiness Fund, was set up to help social enterprises secure capital. The Fund enables social ventures to access new forms of investment and compete for public service contracts. Grants between GBP 50 000 and GBP 150 000 will be available to social ventures who go on to raise at least GBP 500 000 investment, or who want to bid for contracts over GBP 1 million.

### *5.2 United States*

Some say that social investment initially developed in the United States through community investing, which is the provision of financial services to underserved communities and includes banks, credit unions, loan funds, and venture capital funds (Freireich and Fulton, 2009). The Community Reinvestment Act, passed in 1977, played a key role in creating the community development finance industry that has led to significant investment into previously underserved neighborhoods (Freireich and Fulton, 2009). It is a very large and growing market in the United States and increasingly so in Europe.

As in some other countries, interest in socially responsible investment (SRI) began growing in the 1980s. This, coupled with the growth of social entrepreneurship in the 1990s, grew into an interest on the part of investors as well as philanthropists in investing with impact.

Today, a broad group of players are involved in the social investment market in the US Foundations, particularly the newer ones, are exploring new and catalytic approaches to addressing social challenges. Companies have also engaged, developing new models of social enterprise and investment that blend making money and social impact. Universities are important drivers in developing the market through education and training, direct investing and by serving as knowledge and network hubs. Faith based groups have also provided some interesting examples. In addition, there is broader public engagement, particularly from 18-35 year olds ("millenniums") who have a higher alignment of values towards social issues. As a result of all of these developments, the United States is a large test bed for social investment.

In the United States, the majority of social "investments" are still in the form of grants and donations (Rangan et al, 2011). US philanthropic giving was approximately USD 300 billion in 2009. The bulk (75%) was from individuals but about USD 45 billion (13%) was from foundations and USD 15 billion (4%) from corporations. The remaining 8% was from bequests (Indiana University, 2010). The big shift in the United States today is that philanthropists who made money now want to give back while they are still alive. The Founders Pledge (which over 100 philanthropists have now joined) will potentially provide a huge new wave of possible funding (USD 200-300 billion) for social enterprise and social investment.

Foundations and Development Finance Institutions (DFIs) in the United States are increasingly active and interested in social impact investing in developing countries. The Overseas Private Investment Corporation (OPIC) has made major commitments as have foundations and other organizations such Rockefeller Foundation, Omidyar Network and others.

President Obama set up an Office of Social Innovation and Civic Participation (SICP) to spur collaboration to make greater and more lasting progress in addressing social challenges. SICP is focused on strengthening and supporting the social sector by developing policies and programs that can accelerate economic recovery and create stronger communities.

In 2013, the National Impact Initiative (NII) was launched to expand the use of impact investing as an element of the Administration's strategies for economic growth and global development (Saltuk et al, 2014). In addition, the Small Business Administration (SBA), which is active in support funds for small firms and new ventures, has increased the amount available for investment in the SBIC Early Stage Investment Fund. The SBA has also raised the amount of SBIC leverage that impact investing funds can receive (HM Government, 2013c).

The United States also has some tax incentives in place. This includes the New Markets Tax Credits which provides a credit against United States federal income taxes to taxpayers who make qualified equity investments (investments where substantially all of the equity investment is used to provide loans to, or make investments in, low-income communities). The program was authorised by the Community Renewal Tax Relief Act, which was signed into law in December 2000 (HM Government, 2012).

As interest in the Social Impact Bond or "pay for success" model has increased in the United States, the White House has created the USD 300 million Pay for Success (PFS) Fund and a USD 195 million allocation for the Department of Labor to grant to states that pursue PFS projects focused on job training, education, criminal justice, housing and disability services (Saltuk et al, 2014).

### *5.3 Germany*

The social sector in Germany has traditionally been reliant upon State funding resulting in a large and influential non-profit sector already engaged in mass public service delivery. Perhaps partly as a result, the social impact investment ecosystem in Germany is still in its infancy, with a relatively small number of available products. It is a highly concentrated market with few active players. However, the market is forecast to grow moderately in the medium term.

Currently there are two large social venture capital funds **(**BonVenture and the Social Venture Fund which together account for two-thirds of all social investments in Germany) and a small number of engaged family offices, high net worth individuals, angel investors and philanthropists. There is a strong tradition of ethical and church banks who collect funds from retail investors and lend out to social organisations. A crowdfunding platform, Social Impact Finance, was set up in 2013.

In terms of intermediaries, there are advocates of social entrepreneurship, such as Ashoka, and a dedicated financing agency (FASE). In addition, foundations like the two BMW Foundations, Bertelsmann Stiftung & Benckiser Stiftung have been playing an active role in building the market infrastructure. Based on the level of social investment into socially-motivated organisations the cumulative size of the social impact investment market is estimated at EUR 24 million (Weber and Scheck, 2012). New investments in 2012 amounted to EUR 4-5 million. On average, 10-15 deals are closed per year.

The German government has been active in the development of innovation funds for technology and green sectors but was less so, until recently, in terms of encouraging investment in the social sector. Keditanstalt für Wiederaufbau (KfW), Germany's public development bank, has set up a fund to co-invest in social investments and various other initiatives are emerging across Germany. The first social impact bond in Germany has been launched in the area of qualification and work for youths in Bavaria. In addition, the 'NExt SSE' social stock exchange is in the early stages of development.

The German National Advisory Board, set up as part of the Social Impact Investment G8 process, has identified three areas with potential demand for social impact investment, in light of well-known social pressure points in Germany: care of the elderly; qualification and work; child and youth welfare. Social impact investments could in time strengthen the existing financing system by attracting new capital to

finance areas of the social economy currently covered by voluntary rather than statutory provision, notably to allow for more innovation and preventative measures

Further market building is needed, which will require the involvement of a broad range of market participants. The government and foundations, in particular, have a key role to play in moving the market forward (Weber and Scheck, 2012).

### *5.4 France*

In France, there is a long-standing tradition of social economy, which is estimated to be about 10% of the GDP. This is based on cooperatives (60% of cooperative banks assets), mutual companies, associations and social enterprises.

The government has been very involved in helping to develop the social investment ecosystem, including providing incentives for investment. In 2012, France appointed a Minister for Social Economy and has introduced a new law on social economy, which includes commercial organizations with a social mission, not just non-profits. A new public investment bank, Banque Publique d'Investissement (BPI), was established in 2013 which will invest EUR 500 million in social enterprises.

Social housing has been one of the largest sectors in the social economy in France until the more recent solidarity finance system was put in place. These “solidarity finance” or “90/10” funds are based on employee savings and amount to over EUR 1 billion in total. Companies with over 50 employees must contribute and 10% of the funds must be invested in government-recognised “solidarity organisations”. These funds are regulated by Finansol and managed in partnership with banks, microfinance institutions and investment firms. Initially, only non-profit organizations could earn the “solidarity” label, but the rules have changed to now also include commercial businesses with a social mission.

Solidarity finance provides a way to engage “retail” money in the social sector, however, the assumption is often made that the returns on that 10% will be low (while returns on the other 90% will be high). Some argue that returns from solidarity investments should be low, however, others are concerned that this branding gives false impressions about return expectations on both sides. In France, as in other countries, there is a divide between “mainstream” investors and social investors, including an issue of language and marketing (in France, unease with the term “impact investment”).

In France, social investment is first social, then investment. Issues of definitions and profitability remain. As in other countries, there is an ongoing discussion about what should and needs to be provided by State and what can and should be provided by private actors. The French government is actively working on a strategy for further development of the sector.

France is also very engaged in social investment in developing countries, primarily through the French Development Agency (AFD) as well as private investment funds.

### *5.5 Other markets*

National governments are increasingly interested in the social investment market and in establishing more effective public private partnerships to address social, environmental and economic challenges. Australia has been particularly engaged and activity in Canada has increased significantly in the past few years.

The European Commission has been very proactive in supporting initiatives to facilitate the creation, growth and funding of social businesses (European Commission – OECD, 2012). In April 2013, the European Union set up a new “European Social Entrepreneurship Fund (EUSF)” label enabling investors

to identify funds investing more than 70% in European social businesses (Saltuk et al, 2014). In parallel, the European Commission's Group of Experts on Social Entrepreneurship (GECES) has been working on social impact measurement. The European Investment Fund has also become very active in the social investment market, launching a new fund-of-funds.

This increased national and international level attention is important. However, a lot of experimentation and innovation is taking place at the local level so regional and local governments also could be engaged (OECD, 2009).

In addition to growth in OECD countries, social impact investment is emerging as an approach for economic development in developing countries (HM Government, 2013c). These activities have been driven by foundations, international financial institutions and development finance institutions (DFIs).

Development finance institutions (DFIs), governments and others need to collaborate to address global issues and help scale innovative solutions. Public private partnerships are needed to build awareness and global alliances, develop standards and create market infrastructure.

Emerging markets are widening the pool of potential social impact investors by attracting additional high-net-worth individuals and even sovereign wealth funds (HM Government, 2013c). These new and existing actors have an opportunity to work together to build innovative platforms and financial instruments for social enterprises in the developing world. At the OECD/Bertelsmann Foundation workshop in May 2013, it was noted that perhaps there is more room for experimentation outside of OECD countries and that many new models and approaches will likely emerge from developing countries.

In emerging markets, like in OECD countries, there is a shortage of investable deals and philanthropy plays an important role in capacity-building. The amount of support necessary depends on the ambition and skills for scaling. For international scale, long-term and patient capital is needed. Often, grant support is necessary throughout the process, not just at the early stage as often there are no other investors in these markets to which the organization can be passed.

Finally, philanthropy tends to be either local or very distant (e.g. a focus on investments in developing countries). Collaboration, which is critical for the social investment process, can be more difficult from a distance making the role of local partners critical (Bannick and Goldman, 2012). A recent OECD study provides some case studies on the experience foundations have had with venture philanthropy in developing countries (OECD, 2014).

## 6. Addressing Challenges to Growing the Social Investment Market

Interest and activity in social investment continues to grow around the world. There is a greater recognition of the need for effective solutions to social and environmental challenges drawing a growing and broader range of capital providers (Freireich and Fulton, 2009). Interest has also grown among young people who want to pursue careers that have an impact on society more broadly.

Despite the evolution of the market, significant challenges remain. The social impact investment market is at an important inflection point. Awareness, interest and activity have increased but increased transparency and demonstrated results are needed for the credibility and further growth of the market. A range of possible actions to address these challenges are outline below.

### *6.1 Building the evidence base*

A stronger evidence base is critical to increasing engagement in the market and encouraging a global market to develop (HM Government, 2013c). This includes a better and more accurate understanding of

the size, scope and potential of the market. To develop a clearer view on the market, common definitions, language and frameworks are necessary.

There also needs to be more transparency and real knowledge sharing about social investment practices. Currently there is a lot of show casing but not enough learning about what is working and what is not, including about the true costs and efficiencies. More detailed case studies which outline the roles of various actors and the processes involved in structuring social investment products would be useful.

Further data collection would be helpful to monitor developments in the market. Data collection processes which allow for wider comparability, including across countries, would also be useful (Addis et al, 2013). There are data collection efforts within individual organizations and some broader pilot efforts but to date there has not been a forum for discussing how to standardize data collection globally.

In addition, greater information sharing and communication about the social investment market is important to raise awareness and interest as well as encourage international connections and experience sharing (Addis et al, 2013).

### *6.2 Improved transparency and standardization of impact measurement*

While global interest and activity in social investment is growing rapidly, a better understanding is needed regarding how to measure results (HM Government, 2013c). This includes improving metrics for measuring social impact. However, social benefits are subjective and therefore difficult to value, measure and compare. In addition, the process of tracking and measuring these returns can be costly in terms time and resources.

Currently many investors use proprietary measurement systems to determine social and environmental performance, if they are measuring impact in any systematic way at all (Rangan et al, 2011). Many investors rely on anecdotal evidence rather than real evidence (O'Donohoe et al., 2010). While a number of initiatives such as IRIS, SROI and CARS are working to develop standard measures and methodologies, further work in this area is needed (HM Government, 2013c). The European Commission has been working on this issue as has one of the working groups of the international Social Impact Investment Taskforce.

The objectives behind measurement can differ for various stakeholders. Measurement is typically focused on the achievements of the social enterprises. This information is helpful in evaluating the progress of the social enterprises and can be useful in adjusting course as needed. However, it may not provide all of the necessary information investors are seeking regarding their future prospects (Rangan et al, 2013). Further work will need to be done, likely by intermediaries, to strengthen investor understanding of the variety of impact metrics currently available (Jackson and Associates, 2012).

Investors need a common set of tools for assessing social impact measurement. The development of standard measurement systems will be a critical step in further engaging mainstream investors (HM Government, 2013c). At the same time, it is critical to help social enterprises, across different sectors, build greater capacity to measure social outcomes (Addis et al, 2013).

### *6.3 Setting appropriate return expectations*

The growing interest in social investment has also increased expectations. Investors expect not only a social but also a financial return at a time when mainstream investors are struggling to realize financial returns on mainstream financial products. Earlier experiences in social investment indicated that losses were lower than expected and risks were overestimated (Kramer and Cooch, 2006). However, given the

growth of activity and interest in the market, there is a concern that return expectations are becoming too high and risks may be underestimated.

There has been debate as to whether there is a trade-off between social and financial returns or whether social returns can be additional, or even positively correlated (Addis et al, 2013). While current thinking within the market is certainly with the later concept, given the lack of clear metrics and data, it is not easy to prove (Freireich and Fulton, 2009). The positioning of returns on social investment market, especially to mainstream investors, is not easy as social return is hard to measure and different people have different views on how to price or value it. Financial return expectations at least provide quantifiable benchmarks.

While mainstream investors may indicate a willingness to accept below market returns, many still expect private equity risk adjusted returns. Even if there is a decent financial return, management fees for social investment are higher than for private equity/venture capital investments so that needs to be taken into account. While there has been increasing promotion of the ability to achieve both good financial and social returns, it seems this is not possible in all segments of the social investment market. The potential gap between the promise and the reality of returns has a danger of creating a "social economy bubble".

### *6.4 Further development of intermediaries*

The UK Social Investment Task Force highlighted the importance of creating a well-functioning social investment ecosystem which includes a range of capital suppliers, intermediaries and social enterprises (SITF, 2010). The lack of efficient intermediation translates into higher transaction costs caused by fragmented demand and supply as well as complex deal structuring (Monitor, 2009). For these reasons, coordinating capital for social enterprises is more difficult than in the venture capital industry (Kohler et al, 2011).

The lack of an ecosystem infrastructure also impedes the dialogue between finance and impact first investors, which makes it difficult to break down historical barriers between history between philanthropy and investment (Freireich and Fulton, 2009). Platforms are needed to provide accessible distribution systems and offer comparable product performance (Jackson and Associates, 2012). This will also allow better matching of investor and investee risk/return profiles.

The creation of new intermediaries and the strengthening of existing ones is important for creating a well-functioning ecosystem as well as enabling deal flow (Jackson and Associates, 2012). All types of intermediaries are needed to server all sizes of social enterprises (Addis et al, 2013) and players in the ecosystem need to be encouraged and incentivised to collaborate.

### *6.5 Creation of a broader range of financial instruments*

A broader range of financial instruments is needed across the full risk/return spectrum including a better understanding of which financial instrument and funding model would be most effective for social enterprises at various stages of development (Evenett and Richter, 2011). In the annual J.P. Morgan and GIIN impact investor survey, this was once again identified as one of the top issues (Saltuk et al, 2014).

More funds are needed, both investment funds and fund-of-funds, that can aggregate risk and attract mainstream investors (WEF, 2013). In addition, more innovative new products like Social Impact Bonds (SIBs) and Development Impact Bonds (DIBs) can trigger a rethinking of models for addressing and financing social challenges.

Catalytic, or first loss, capital continues to play an important role in the development of the market (GIIN, 2013). These include grants and technical assistance for social enterprises and the development of

additional financial products to meet the varying needs of these enterprises. Social enterprises operate in a wide range of geographies and sectors. The types of social outcomes vary tremendously as does the ability to generate a financial return (including a 0% return to recover investment).

The financial solutions to support and scale their work also need to be diverse and there needs to be a better understanding of where social investment can have the greatest impact (HM Government, 2013c). In a co-mingling fund, philanthropic money, usually from a charitable foundation, is invested alongside commercial funds using structures that enable both sides to bring their unique experience and assets to fund ventures seeking both a social and financial return (HM Government, 2013a).

### *6.6. Enhanced focus on the demand side*

As noted throughout the paper, there is a lack of investor ready social enterprises. Creating more investable deals will require improving financial skills in the social sector as well as developing a better understanding of risk and how to price it (Brown and Swersky, 2012). Transaction and reporting requirements can be high for social enterprises (OECD, 2013) so investors should find ways to streamline these practices.

It is also important to find effective ways to improve the management capacity of social entrepreneurs and to help them grow their ventures (Jackson and Associates, 2012). This could be through training programmes and/or mentoring. Social accelerator programmes and funds, such as the UK Investment and Contract Readiness Fund, can be helpful (Addis et al, 2013).

Mission drift is another challenge for social investors and entrepreneurs. This can be overcome, to some degree, by incorporating social parameters (clauses in term sheets and covenants) into investment documents to make sure both the investor and investee remain aligned to the social mission.

### *6.7 Further engagement of mainstream investors*

Despite the increased interest among institutional investors, securing commitment from traditional investors continues to be a challenge. The approach to institutional investors needs to be structured in way that works for them and in a language they can understand. Initiatives, such as GIIN, ANDE and SOCAP, which build links between mainstream and social investors, can help to create awareness and increase interest. Institutional investors also have certain legal requirements which can create barriers to social investing (Wood et al, 2012).

To date, institutional investors have funnelled most funding into microfinance, which has a track record for delivering financing returns. As noted earlier, most institutional investors require at least a market risk adjusted financial return and therefore are limited in terms of how far along the social investment spectrum they can move (Jackson and Associates, 2012).

In addition, investors want clearer measurements of social impact. Several foundations and other investors are creating their own systems, however, a common language is needed. To do so, more transparency is needed in terms of how funds define, track, and report on social and environmental performance. The Impact Reporting and Investment Standards (IRIS), in collaboration with other impact investors and industry experts, has developed a standard set of performance measures for describing social and environmental performance to facilitate comparisons of impact data across investments. This common social and environmental vocabulary can also enable the aggregation of data from different providers and data collection systems.

Another challenge in engaging mainstream investors is the lack of sufficient absorptive capacity for capital (Freireich and Fulton, 2009). There is a scarcity of high quality investment opportunities into which

larger amounts of capital can be deployed. As in the mainstream financial markets, investment evolution is not necessarily linear although it is often assumed to follow a path from individual transactions, to boutique offerings to funds, funds of funds and ultimately fully "liquid", or tradable, capital markets where investors have a range of choices to buy and sell investments (Bugg-Levine and Emerson, 2011). More products could be developed, across the risk return spectrum, into which institutional investors can deploy social impact investment funds.

### *6.8 Engaging governments and other stakeholders*

One of the key challenges for government is identifying where the social impact investing agenda should be housed (HM Government, 2013c). In the United Kingdom, there is a Social Investment Cabinet Office with dedicated staff and budget. In the United States, there is a White House Office of Social Innovation and Civic Participation. In 2012, France appointed a Minster for Social Economy. However, in many other countries, social enterprise, and the newer topic of social investment is not yet handled at the top level of government.

The Social Impact Investment Taskforce established by the G8 in 2013 has helped to raise awareness about social investment in G8 as well as G20 countries. In addition, further work conducted by the OECD in this area can help to inform OECD member countries about developments in the social investment market and consider if and which policy actions might be taken. The IIPC has recently developed a set of principles aimed at highlighting potential policy areas (see Box 5 in section 7). All of this work can help further engage governments to considering developing policies to increase the supply of capital, strengthen demand and facilitate the market development for social investment (Jackson and Associates, 2012).

As the market develops, the engagement of other stakeholders is also important (Schwab Foundation, 2013). These include educational institutions which can play a critical role in the training of both social enterprises and social investors (Brown and Swersky, 2012). General awareness raising through the media can also further momentum for the market, however, expectations need to managed in terms of realistic outcomes (Addis et al, 2013).

## 7. Policy implications

There are a number of market failures in social investment. As in the mainstream financial markets, there are information asymmetries between investors and investees. These asymmetries are further compounded by the lack of commonly accepted standards for measuring social investment, confusion of terminology and lack of information about both existing investment provision as well as related government policy (HM Government, 2011). There is also imperfect competition in the market due to high transaction costs as well as the lack of brokers, advisors, exchanges and other market mechanisms.

Other market failures include externalities and the absence of incentives to invest in sectors with public good properties. The social returns generated from social investments are primarily external to both the investor and the investee as the social aims are typically targeted to certain groups or society as a whole. Given the market inefficiencies, these externalities are not priced into social investment transactions (HM Government, 2011). Social investment leverages the private markets to provide public goods, however, the mechanisms to do so are not efficient and therefore can benefit from government intervention (Thornley et al, 2011).

The public sector can play a catalytic role in the social investment market in terms of creating a conducive regulatory environment, encouraging greater transparency and taking concrete steps to help develop the market. These actions can be taken at the international, national or local level. However,

actions initiated in one country or region may not be appropriate for another – policy objectives, experience and local context must be taken into account.

Government policies should enable entrepreneurship more broadly by creating the proper framework conditions, including tax and bankruptcy policy. This includes promoting and ensuring competition which creates choice, transparency and openness. As noted earlier, human capital development, through education and training, is also important.

In terms of specific actions, governments can ensure the necessary legal frameworks and structures are in place as well as streamline regulations and requirements for investment (Thornley et al, 2011). This includes the creation of corporate structures more suitable to social ventures discussed earlier in the paper. They can also provide support through tax credits, guarantees or subsidies. Additionally they can provide support to investees through technical assistance or procurement.

Policy makers can also help in raising awareness and understanding about social investment by supporting research and data collection. They can also facilitate the development of the ecosystem through capacity building and the development of intermediaries. Examples of all of these types of measures were provided in earlier sections of the paper.

At the G8 Social Investment Forum in June 2013, it was suggested that policy actions must be bold in terms of scale and resources to catalyse new and more effective models and approaches. Patience and long-term support is needed to develop the market. Creating and investing in new innovative social ventures and building supporting ecosystem takes time and results might only be seen after 10 years or more (HM Government, 2013c). Policy is long-term but politics can be short-term so there is a danger that the increased level of government interest and involvement in this topic might decline in the shorter term if the necessary results are not forthcoming.

In July 2013, the Impact Investing Policy Collaborative (IIPC), in collaboration with policymakers, researchers and other stakeholders, presented *The London Principles*, a set of guidelines intended to assist governments considering impact investing as a tool to address social objectives (see Box 5).

New and inefficient markets can often benefit from government involvement. Certainly, the social investment market is in its early days and needs to find scalable models. As policy makers seek to facilitate the development of the market, they should keep in mind that public support should be a catalyst and avoid "crowding out" of the private sector in order to ensure the creation of a sustainable market. Government intervention, while well-meaning, can have unintended consequences (for example, EUSIF).

It is important that the policy interventions are well targeted, transparent and well-coordinated with existing policies as well as with the market (Thornley et al, 2011). Policies should also be consist so that market players both understand the implications of the policies and have some visibility in terms of how long the policies might be in place. Evaluation of the policies is also important to make sure that the policies are having the intended results.

The government can play an important role in catalysing social investment; however, it is important to clarify the role of the State versus private investors. It is hard to "compete" with the State and too much involvement from the government can impede the development of the social investment market.

**Box 5. The IIPC London Principles**

**Clarity of Purpose**

Clarity of purpose, on the part of government, reinforces strategy and policies that are integrated into existing policy and market structures, that target specific social objectives, and that clearly define the role for impact investing in achieving those objectives. Clarity of purpose allows governments to avoid inefficient use or misallocation of resources, insufficient policy support that impedes achievement of outcomes, and disjointed policy regimes.

- Clearly identify the social objective(s) that the impact investing strategy or policy is meant to target.
- Clearly identify why the impact investing strategy or policy might be an appropriate tool to meet those objectives, and how impact investing complements broader policy systems.
- Define realistic expectations for the results the impact investing strategy or policy might achieve and the time it might take to achieve them.

**Stakeholder Engagement**

Stakeholder engagement brings discipline and legitimacy to policy design. By institutionalizing dialogue and feedback, with relevant stakeholders, governments can bring important additional resources to support impact investing strategies and policies. Effective stakeholder engagement ensures that all actors are included, manages expectations, and avoids the development of policies that are unfit for purpose.

- Identify, engage, and collaborate with key stakeholders, from concept to implementation to revision of strategies and policies.
- Support shared ownership of policy and a dynamic process of policy development and review.
- Guard against misaligned incentives or unequal power structures that work against effect impact investing strategy and policies.

**Market Stewardship**

Market stewardship ensures a holistic vision for impact investing strategies and policies. It focuses on a balanced development of investor interest, investment opportunities, and mechanisms to deliver intended social outcomes. Effective market stewardship sets appropriate levels of regulation and mitigates unnecessary management of market activity.

- Identify the appropriate use of market interventions, including at which point they should be made, for how long, and by which agencies and institutions.
- Develop markets holistically, balancing capital supply, investment readiness, and support for enabling intermediary infrastructure.
- Support reliable and responsive policy, mindful of stakeholder priorities, incentives and limitations.

**Institutional Capacity**

Institutional capacity allows for the effective use of resources, adds value to existing policies, and creates the potential for developing innovative strategies and tools that address key social problems. Institutional capacity establishes reliable and resilient markets, and avoids sending mixed signals to investors and civil society on the potential for intended policies to deliver on their promises.

- Determine cross-sector resources within government currently available, or necessary to be developed, for successful strategy development and policy implementation.
- Develop public sector leadership to implement policies where needed and provide stability over time.
- Measure and evaluate the impact of policies against stated objectives, and act efficiently to refine or scale accordingly.

**Universal Transparency**

Universal transparency mandates that stated objectives are clear, and progress toward their achievement is openly measured and reported to relevant stakeholders and the public at large. Effective universal transparency enables leadership in public innovation, protects against the risk of real or perceived bias, realistically manages expectations, and empowers citizen participation.

- Report rigorously on performance and develop a culture of transparency that includes all impact investing actors.
- Commit to a continuous process of shared learning, including through an open dialogue on successes and failures.
- Foster engagement and fidelity to stated social objectives.

*Source*: http://iipcollaborative.org/london-principles/.

## 8. Next Steps

Social investment can potentially provide new ways to effectively allocate public and private capital to address social, economic and environmental challenges at the global, national and local levels. While these new approaches will not replace the need for philanthropy or public sector involvement, they can provide models for leveraging existing capital using market-based approaches to have greater impact (Rangan et al., 2011). To create effective and innovative models, social enterprise and investment should be seen as an important component of new sources of economic and social growth, not as a "sideshow".

Clearer definitions of social investment markets are needed, including potentially new frameworks for thinking about the field. Sharing of knowledge and experiences about this diverse and growing market is important for building the market globally. It is crucial to understand what works to ensure that capital is put to work on interventions that achieve the intended results. This includes the collection and sharing of data as well as collaboration on new models and approaches.

As a first step in this direction, this paper has provided an initial overview of social investment and developments in selected OECD countries. It has highlighted the evolution of the social investment market to date as well as some of the challenges and actions needed for future growth. It has also discussed the role that policy has and can play in this evolving market.

Developing a stronger evidence base on the social impact investment market will be crucial to increasing engagement and further developing the global market. To respond to the need for a better understanding of the potential of the market, the OECD was asked by the Social Impact Investment Taskforce, established by the G8, to undertake a detailed report on global developments in social impact investment. This work is currently underway and a first report will be published in September 2014.

That report will provide a framework for identifying and scoping the key components of the evolving social investment field on a global basis. It will be a resource for governments and industry to assess what can be done to build a global social impact investment market. The work will involve Directorates across the OECD and include research and data collection in G8 and potentially other OECD and non-OECD countries.

The work on the OECD report is taking place in parallel with the work of the Social Impact Investment Taskforce, established by the G8, which has put a series of working groups in place. In addition, National Advisory Boards were created in 2013 and have been meeting on a regular basis to provide input to the work of the Taskforce. Reports from the Taskforce and the National Advisory Boards will also be published in September 2014. These reports are meant to feed into future G8 and perhaps G20 discussions.

The social investment market remains small relative to traditional markets however it is growing in visibility and importance. Further growth will require coordinated action and sustained engagement from a broad spectrum of market participants (Brown and Swersky, 2012). The key in the coming years will be for market players to be able to demonstrate results, clarifying the benefits at the firm and societal levels.

# GLOSSARY

## Social investment

Social investment is the provision and use of capital with the aim of generating social as well as financial returns. Social investment carries an expectation of repayment of some or all of the finance. It can cover loans, equity, bonds, and is sometimes used alongside other instruments, such as guarantees or underwriting. As with any other investments, where the investee business performs well, returns generated may be principally reinvested in the business, as well as offered to investors. Investors in social outcomes weigh up the balance between the social and financial returns which they expect from an investment, according to their own priorities. They will often accept lower financial returns in order to generate greater social impact. (Source: City of London, 2012)

## Impact Investing

Impact investments are investments made into companies, organizations, and funds with the intention to generate social and environmental impact alongside a financial return. Impact investments can be made in both emerging and developed markets, and target a range of returns from below market to market rate, depending upon the circumstances. The practice of impact investing is further defined by the following four core characteristics: i) *Intentionality;* ii) I*nvestment with return expectations;* iii) *Range of return expectations and asset classes;* and iv) *Impact measurement*. (Source: GIIN website)

## Venture Philanthropy

Venture Philanthropy is an approach to build stronger investee organisations with a societal purpose by providing them with both financial and nonfinancial support in order to increase their societal impact. The venture philanthropy approach includes the use of the entire spectrum of financing instruments (grants, equity, debt, etc.) and pays particular attention to the ultimate objective of achieving societal impact. The approach includes both social investment and high engagement grant making. (Source: EVPA website).

## Corporate Social Responsibility (CSR)

CSR is defined as the integration of business operations and values, where the interests of all stakeholders—including investors, customers, employees, the community, and the environment—are reflected in the company's policies and actions. Special attention is given to corporate practices as they relate to environmental, social, and governance (ESG) performance. (Source: Adapted from Freireich and Fulton, 2009)

## Socially Responsible Investing (SRI)

SRI is an investment approach that generally employs negative screening to avoid investing in harmful companies which are creating negative spillovers in society through their activities (e.g. Tobacco companies, weapon manufacturers). Today large amounts are invested under an SRI approach which has implications for shareholder activism/advocacy to be able to encourage corporate social responsibility practices. (Source: INSEAD adapted from Palandjian, 2010)

**Program Related Investments (PRIs)**

Investments, which often take the form of loans, loan guarantees, or equity investments that are derived from a foundation's assets but count toward its charitable distribution requirement. Generally, these investments yield below-market-rate returns for the foundation. (Source: INSEAD based on Lawrence and Mukai, 2011)

**Mission-Driven Investing (MRI)**

MRI is a term used to describe mission-related investments that are market-rate investments of endowment funds that align with the social or environmental mission of a foundation. MRI can include the use of social investing tools and sometimes including shareholder advocacy and positive and negative screening. (Source: Rangan et al., 2011)

**Social Entrepreneurship**

The pursuit of sustainable solutions to neglected problems in society involving positive value spillovers. Social entrepreneurship is a process, a logic of action, that can take place in different organizational contexts: a charity, a commercial organisation, a government organization, a community organisation, or through a new venture. It is characterised by a set of principles that are typically present: focus on value creation not capture, focus on innovation not the status quo, focus on sustainable solution not sustainable organization, and focus on empowerment of participants in the value chain not control of industry forces. (Source: INSEAD, based on Santos, 2012)

**Social Enterprise**

Any private activity conducted in the public interest, organised with an entrepreneurial strategy but whose main purpose is not the maximisation of profit but the attainment of certain economic and social goals, and which has a capacity of bringing innovative solutions to the problems of social exclusion and unemployment. (Source: OECD, 2000)

**Social Business**

A non-loss, non-dividend company designed to address a societal problem through a market-based business model. It is distinct from a non-profit because the business should seek to generate a modest profit which will be used to expand the company's reach, improve the product or service or in other ways subsidise the social mission. (Source: INSEAD adapted from Yunus, 2009).

**Social Purpose Organization (SPO)**

An SPO, whether nonprofit, for-profit, or hybrid, seeks to create positive social impact for human society, animals, or the natural environment in the form of social value that is not limited to economic wealth for owners or consumption benefits for customers. (Source: Clark et al., 2012).

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