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SOCAP11: Impact Investing Special Edition

ENTREPRENEURIAL SOLUTIONS TO GLOBAL CHALLENGES

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Prefatory Essays

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Analysis

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Innovations is about entrepreneurial soultions to global challenges.

The journal features cases authored by exceptional innovators; commentary and research from leading academics; and essays from globally recognized executives and political leaders. The journal is jointly hosted at George Mason University's School of Public Policy, Harvard's Kennedy School of Government, and MIT's Legatum Center for Development and Entrepreneurship.

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Kevin Doyle Jones

Capital in the Social Capital Market

Convener's Message

As envisioned by the robber barons who created the U.S. stock market, capitalism was designed to be a force beyond the boundaries of ethics, focused solely on profits and maximizing financial return. But a new movement has arisen with a different foundational myth: that capital is the fuel for changing the world, through the social capital market. This movement views business as a tool men created, one that can be brought back under control to serve a global community in which injustice has a cost to all and quantitative growth has limits.

The past decade has shown that those who go after money with no motive other than making more money are dangerous, but those who seek meaning without capital are limited in their ability to scale fast enough to meet the onrushing challenges the global community is facing. The social capital market, which sits at the intersection of money and meaning, seeks both. Investors don't enter the social capital market to make money; they come in to make a difference and get a positive return on their capital. Sometimes that return is financial first, sometimes it's impact first, but both sides of the spectrum are needed to build the market at the intersection of money and meaning.

The social capital market looks at value across asset classes, from grants, to subsidies, to mission-sensitive debt, to impact-first venture equity to return-first impact investing. It is a market where it is acceptable to count the cost of doing good and the compromise to return in a philanthropically motivated but rigorous investment decision.

I propose that the social and environmental value created and the good accomplished for the people and the planet, when it extracts a cost to profits, exists as a value in the commons. It's that part of the blended value created by a social enterprise that does not on the balance sheet. Our impact metrics are typically only a single input into a much more complex system where one impact investment intervention's impact interacts and benefits or collides with another intervention, when you don't know if the gain was caused by your agro-ecology social enterprise

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Kevin Doyle Jones is the convener of the Social Capital Markets (SOCAP) conferences, the world's leading gathering for impact investors and social entrepreneurs. The gathering of the market at the intersection of money and meaning attracts more than 1,500 people from over 50 countries. He is also a Founder of Hub Bay Area and of Good Capital, and edits the Good Capitalist newsletter. (Twitter: @kevindoylejones)

that resulted in more and better food in poor communities while it improved the soil and the climate, may have benefited from the literacy or renewable, locally produced energy projects in the same village. The transaction costs of accurately counting that interchange of value, since measuring does not typically add economic value, will never be supported. Counting just our social enterprise's impact is a dead end. That's why learning the rules that govern efficient commons is important.

We define value through both relational and financial lenses; as Jed Emerson, who provided most of the theoretical underpinning of the framework of impact investing (see BlendedValue.org), said a long time ago, what we want is value, and we are willing to pay for or invest in or give to things that provide value.

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In this way, the social capital market is a cognitive landscape. It addresses both what people value, and whether or not they can make enough money to support what they value. People historically have thought of giving money as taking it out of one pocket set aside to do good, and of investing as putting their money into another pocket with the hope of making more money. However, this space in between giving and investing—the social capital market—includes elements of both. In this market, individual and collective assets are both on the balance sheet and in the commons, and equal weight is given to what's good for the investor and what's good for all of us and our planet. Because of this creative tension, people and planet need to be at the core of the social capital movement and of equal importance as profit.

Traditional capital markets rely on the big investor dollars, from Goldman Sachs to Warren Buffett, whereas the social capital market is becoming much more democratic and the power of money alone is growing smaller. Impact investors are in fact becoming a surplus commodity, while there is a scarcity of entrepreneurs who can build something beyond themselves. Thus the power is shifting toward the entrepreneur and away from those providing the fuel.

The social enterprise movement began with a hero phase, and the visionary founder does have a vital role. However, it's time to get over our hero fixation, which is almost as much of a hindering myth as thinking that investment is only about return. These days it's not about the heroic social entrepreneur but about the social enterprise. What we need are people who can make a dream a reality, who follow in the visionary's footsteps to build something bigger and better. As someone who recently stepped down from operational control of a business I own when it grew beyond me and installed high-quality managers and leaders to handle the next stage, I know that allowing a business to outgrow the founder is essential for real success.

Because there are so many people with a lot of money who want to have an impact while getting some level of financial return, the focus should be on creating the next generation of fundable entrepreneurs. That means growing the number of players providing and defining a new kind of seed capital. This capital must carry a high tolerance for risk and the many inevitable failures that ensue, which will be compensated for by two things: by understanding that they are literally seeding the field of market-based innovations the world desperately needs, and by the prospect that from their intelligent seeding there will emerge a number of stellar enterprises that are investable, and that have a proper mix of impact and financial return—including some that even return-first impact investors will find attractive.

To make that happen, I like the promising Village Capital model, a seed-funding network our own Hub Ventures is part of, where the entrepreneurs themselves do due diligence on their peers. The experience empowers the entrepreneurs, who are given capital to deploy, and investors, who have to let go of control. Also in that small group of smart new seed funds is Invested Development, which puts discipline and professionalism behind $10 million given by a single super angel and invests it in seed-stage companies engaged in renewable energy and mobile transactions in sub-Saharan Africa.

But not all the capital power comes from accredited investors in funds. I am amazed at the rapid growth of collaborative commerce and crowd-funded investing as tools for making change that are available to all of us. They work best when enmeshed in learning loops—positive feedback networks that enhance our collective intelligence.

This people-powered capital shows up in the way they buy and the way they invest for good at the level of the cash that's in their wallet—retail investing with meaning attached, like Microplace and Kiva, or the Hoop Fund. The average person can't issue a bank loan, but investing just $25 through a loan platform such as Microplace or Kiva can make a big difference. With the Hoop Fund, people can either buy fair trade coffee or clothes, or invest in the people who produce the products. People clearly can make a bigger difference by sharing—using Zipcar instead of buying a car or sharing a desk at the Hub instead of renting office space are two good examples. People can reduce their use of scarce resources while creating a more socially constructed economy in which personal and collective relationships, managed well, reduce costs and increase margins. The most money may be made in the next decade in companies that maximize sharing and reuse, as production and transportation costs increase and 2,000-mile supply chains make less and less sense.

People-powered capital works for the social capital markets because the market is partly in the commons. The work of Elinor Ostrom, Charlotte Hess, and other economists in defining the design principles of systemic and resilience-producing commons, such as well-functioning watershed management systems, is important to add to the social capital market toolset. There is a lot of good research that is guiding people about ways to make use of pooled resources that result in abundance rather than tragic scarcity. I think these guides could be increasingly important to effectively broadening the current practice of narrowly measuring a particular intervention's social or environmental impact or how it bumps into another social enterprise's claim.

The focus should be on creating the next generation of fundable entrepreneurs.

Value created that does not live on a balance sheet is intrinsically shared. Impact value, the value a for-profit or a nonprofit social enterprise creates for the benefit of people or the planet, lives in the commons. Funders who want the powerful feeling of connecting their dollars in a direct line to having an impact on the world are going to be frustrated as that truth becomes clear.

The thinkers and doers need capital, particularly seed capital. For all the talk in the sector, there are only five impact funds of more than 250 people that are providing seed capital. The rest of the money comes from the people—people who are spending less through collaborative consumption, sharing more through crowdfunding, and building collective efforts through peer-led due diligence, such as the 16 entrepreneurs in a Hub Venture cohort, for example, who chose which of the other enterprises in their cohort get that session's three investments. The big investors aren't stepping up at the seed stage, so the people are fueling a movement they believe—and hope—will change the world.

While actual tangible support beyond lip service has been hard to get from government sources in the United States, on the other hand, some intriguing partnerships are brewing between social enterprises and corporations that have created various technology-focused challenges and are now looking to take them to the next level. And in government, OPIC, for example, is creating low-cost debt for international impact investment funds.

And how do these enterprises measure the impact they are having? At GoodCap, we measure the good each investment is doing in the world, which is more difficult than it sounds. We can't make the metric a drag on performance, so we try to use it as a management tool for the entrepreneur, who must use it to report on the value he or she creates, and what that social or environmental value costs the company. That's important information for an investor.

We also should measure the cost of the social impact delivered against the absolute market return that could be made if the negative consequences of what it takes to drive a profit margin could be ignored: the cost to the planet and the people, to those who want their grandchildren to thrive. In other words, is there a trade-off? How much does your mission cost your business, or the business you have invested in, or the total fund's financial return? Lining up your limited partner investors with your mission goals is a complex, relationship intensive process.

As we measure its financial and social returns, the shape of the social capital market is becoming clearer. There are sectors that have been sized and are investable without microfinance's moral risk—the risk of being part of the unintended consequence of saturating a region with debt and extracting too high a return on equity so that the total positive benefits can be legitimately questioned, at least by impact first investors.

By contrast, the renewable, locally produced energy in rural India and sub-Saharan Africa segment has some inherent elements of what I call Mission Insurance. The market for rural, locally produced, sustainable energy in the developing world cannot be saturated; local, culturally sensitive partners are needed to handle payments, repairs, and installation, etc. Absent that element, the money to be made from the technological innovation is potentially high return, while removing kerosene, which is a major contributor to killing 1.5 million people a year, will neither make money or have a positive impact. In that market, as well as with mobile transactions that accompany product sales, as platforms built by companies like Simpa are adopted to set up a metered payment system that brings the products within the budgets of people making $4 a day, it is anthropology, not just the technology—knowing what works where and whom to trust where—that leads to success.

We've created a young, fast-moving market, but it needs to become a "grandfather" market—that is, the kind a grandfather would create if he lived around his grandchildren. At its best, the social capital market is multigenerational, and it must work for all people: children, women and men, the elderly, the infirm. People are not statistics on a balance sheet to be pushed about as the market dictates or tools in a game where the level of growth is the only thing worth focusing on.

To create this grandfather market, we need to stop searching and waiting for the heroes and begin putting seed capital into the implementers, the executors, the workhorses. We need to stop waiting for the big fish to put in big dollars and instead create, grow, and expand the structures within which people can both power and feed off capital.

What if entrepreneurs could invest in each other? What if the average person could invest in these businesses that can create a huge positive social and financial impact but need more fuel, and more goodwill from more people, to get there? What if consumers could finance the co-ops and fair-trade products they buy? What if I could share my workspace and my home with other builders who share my values? The social capital markets are attacking these questions head on, and they will be front and center at SOCAP11, held September 6-9 at Fort Mason in San Francisco.