Social Investment

The internet, climate change, and soaring volumes of international trade have, over recent years, brought about a profoundly heightened sense of global interconnections. World flows, more than ever before, are defining world conditions. The increased outreach of multinational corporations, and greater awareness of the length and intricacy of supply chains, have brought ethical questions into company board rooms; at the same time the growing international carbon trade represents a strong desire to cross-weave approaches to what threatens to be a truly global problem. Business, it is becoming clear, does not operate in a world parallel to social or environmental concerns. In fact far from it – the two are mutually embedded, and as people more and more come to regard themselves as stakeholders in a single world, the more congruency they will demand in the furthering of vested interests.

In contrast to the traditional model of philanthropy, by which people are profit-maximising with one hand, and then giving away profits with the other, the social investment model seeks to co-align financial and ethical interests in a single coherent strategy. Thus the capital itself, rather than just a charity run-off, is able to further the mission-interests of the investor, and produce a ‘blended return’ – i.e. one composed of both financial and social or environmental benefits. Together these elements compose a double or in many cases triple-bottom line. This blending offers a number of key advantages:

- A socially invested portfolio expresses the values and beliefs of the investor, fostering a strong connection between the owner of the money and what that money is being used to do.

- As the capital is invested not donated, it remains in circulation, thus leveraging increased social impact through successive redeployments.

- The market discipline of invested capital obliges socially-motivated organisations to engage in profitable activities, encouraging sustainability.

- Conflicts between profit-maximising investments and philanthropic activity are avoided. The reality of such conflicts was notably flagged up in 2007, when it was revealed that investments made by the Bill and Melinda Gates Foundation were frequently in companies whose activities (chiefly through pollution) were contributing to the very problems which the Foundation’s grants were attempting to address.

The practice of financial-ethical coherence, or value-conscious investing, has some history, stretching back to the co-operative credit organisations of the nineteenth century. Over the past

three decades socially-motivated banking has grown considerably, with organisations such as Triodos Bank and ShoreBank now managing balance sheets in excess of US$2 billion. However it has been over the past decade that business-style approaches have engaged in large-scale and innovative ways with traditionally Third Sector issues, and the blended space has started to explode. Many social businesses have achieved consistent and impressive growth year on year, delivering financial returns to investors mostly between 2 and 8%, as well as considerable sustainable social and environmental benefits. As the model of for-profit socially-motivated enterprise creates stronger and stronger proofs of its viability, investment opportunites are proliferating, with new businesses starting up, and mainstream players such as Deutsche Bank and J P Morgan getting involved and creating funds. It has been suggested that we are still in the early moments of a blended space Big Bang, and given current levels of interest in tackling both climate change and global inequality, as well as the scale of the problems, and the clear need to integrate business into the solutions, it is likely the sector will continue to expand very rapidly.

A social investment can broadly be defined as one in an organisation (or fund for such organisations) whose primary mission is to achieve social or environmental benefits, and whose method for achieving these benefits is through profitable trading. The nature of the trading can vary widely, but as long as the trading itself is the driver for mission fulfillment, profitability should not conflict with impact, and what is good for business is equally good for communities and environments. Examples include microfinance, where the successful repayment of a loan not only allows the microfinancier to be profitable, but equally indicates that the microborrower is using credit sustainably and effectively to grow their business. Equally, for a fair trade coffee retailer, increased sales allows the retailer to purchase more fair trade coffee, and thus spread fair trade practices among developing world growers. Similarly, for a host of clean technology companies, the more clean tech installations they are able to put into operation, the more carbon emissions they will displace.

However, while the organisation should be profitable thanks to not in spite of its mission, thus safeguarding the investors' blended return, the size of the financial return to investors may have to compete with the organisation's desire to fund its own expansion, or to offer its services at lower costs. This second situation may arise in particular among organisations serving impoverished communities (with e.g. financial services, energy, clean water, healthcare etc.), where higher returns to investors are sometimes sacrificed in order to ease the burden on the poor. Nevertheless, the profitable model of operation remains critical to the organisaion's intent to be self-sustaining and to grow, and thus further provision of the much needed services. Frequently investment of-

ferings will state an intended rate of financial return, which the organisation will have weighed up against their own margins and projections and desire to remain attractive to investors. This allows investors to determine in advance what rate of return they would find accetable, and to select and reject investments accordingly.

The impact quotient of the blended return may be compromised by mission drift, whereby an organisation's operations move subtly away from their original focus (e.g. a microfinance institution may find itself drifting toward larger loans to more successful entrepreneurs and SMEs, thus leaving behind the real microborrowers it originally set out to serve). A number of organisations publish a social audit which is distributed along with the annual report. This allows investors to maintain a close relationship with the impacts being achieved, and to watch for mission drift.

Social investors are likely to self-steering in terms of their appetite for risk, their requirements for financial return, and the particular areas where they wish their impacts to be directed (e.g. developing world vs. UK-focused, chiefly social or environmental etc.). At present, social investment opportunities tend to be medium to long term (5 years or more) with little or no liquidity, and are more likely to be debt than equity based. Not infrequently an investor will be expected to take on a level of risk not compensated to a fully commercial standard by financial return, and in such cases the investor may need to consider the impact aspect of the blended return in order to rationalise the risk. However increasingly sophisticated structured offerings are emerging, where subordinated layers of debt are taken by foundations and highly socially-motivated investors in order to offer well-cushioned senior debt, with fully commercial levels of financial return, to more mainstream investors. As the nascent universe of social investing continues to expand, it is expected that more liquidity and more innovative financing will come into play.

Due to the immense diversity of social investments, risk comes in many different forms, often specific to an individual investment. However broader kinds of risk can be identified which do apply to large parts of the sector. These include:

- Developing Country Risk – many social investments are, either directly or indirectly, in operations in developing countries. As such, these are inevitably subject to a wide variety of risks including potentially unstable political environments, less solid legal and financial structures, and, in some cases, currency risk.

- Early Stage Risk – many social businesses are early stage companies with unconventional new business models, representing innovative approaches, which are necessarily largely untested. Companies may have limited financial history and experience of debt. Moreo-

ver market data for comparable operations may not exist. Companies pioneering new technologies, especially clean tech companies, will present technology risk.

- Policy and Donor Risk – business plans of mission-driven companies are not infrequently predicated upon sympathetic policy environments (e.g. renewables targets for green energy providors) which may be subject to a change in political climate. Sometimes social businesses will be looking to take investment in addition to or as part of a move away from grant or donor funding, which may not be guaranteed.

However, a significant upside for investors comes in the form of diversification. Because social investments tend to focus on new or underserved markets, often with very little correlation to mainstream markets, they offer investors the opportunity to spread investments across a broader remit of operations and thus lower overall portfolio Beta. Moreover it has been observed that mission-driven organisations which are able to marry the passion and commitment of their management with an effective strategy to tackle an unmet need are able to show strong growth even through economic downturns.

At Investing for Good we provide advice and market expertise across the social investment sector.