A Center for Law, Technology, and Entrepreneurship at the University of Colorado

Silicon Flatirons Roundtable Series:
Encouraging Social Impact Through Private Sector Leadership

Thursday, May 7, 2015, 11:45 AM - 3:00 PM
University of Colorado Law School, Colloquium Room 480

The development of "social impact" as a category of investing has raised a range of legal and policy issues. On the legal front, a crucial question remains of whether, when, and why a for-profit entity can prioritize goals other than maximizing shareholder returns. The rise of B Corps, for example, offers a notable case study where social impact might well justify a departure from the usual corporate law norms. When social impact is a core corporate goal, law and policy will need to determine how to measure, certify, and validate what constitutes a true and sufficient social impact. Another such question arises in connection with the tax rules that govern how foundations can invest in for-profit entities that advance social impact goals. The US National Advisory Board on Impact Investing has called for changes in this area—to provide foundations more freedom to do so—and the topic is attracting increasing attention.

This Roundtable will explore these questions by bringing together leaders in this space to discuss policy strategies and the necessary legal infrastructures for supporting such initiatives. The discussion will be moderated by Silicon Flatirons Executive Director Phil Weiser, will follow Chatham House Rules (not quoting participants without their permission), and provide the basis for a short report that captures the gist of the conversation

Agenda

11:45 - 12:00	Welcome and Introductions
12:00 - 12:45	The Advent of B Corps: Their Promise, Progress, and Obstacles to Growth *Firestarter:* Kim Coupounas - B Lab Colorado, Director
12:45 - 1:30	Measuring Impact: Towards Common Definitions and Standard Measurements *Firestarter:* Jed Emerson - Gary Community, Senior Advisor
1:30 - 2:15	Policy Implications: Taxes, Public Markets, and Program Related Investments *Firestarter:* Monisha Merchant
2:15 - 3:00	Summing Up: Conclusions and Opportunities for Further Work
3:00	Dessert Reception

Background Sources

Herrick K. Lidstone, Jr., The Long and Winding Road to Public Benefit Corporations in Colorado, *The University of Colorado Law Review* (January 2014) (SKIM).

William H. Clark and Larry Vranka, The Need And Rationale For The Benefit Corporation: Why It Is The Legal Form That Best Addresses The Needs Of Social Entrepreneurs, Investors, And, Ultimately, The Public (January 18, 2013) (SKIM).

Colleen O'Connor, Colorado in the forefront in transforming the workplace, *The Denver Post* (June 1, 2014).

Jo Confino, Will Unilever become the world's largest publicly traded B corp?, *The Guardian* (January 23, 2015).

Dennis Price, How Etsy's IPO Could Spark Investor Interest in B Corps (March 10, 2015).

US National Advisory Board on Impact Investing, Private Capital, Public Good: How Smart Federal Policy Can Galvanize Impact Investing and Why It's Urgent (2014).

Organization for Economic Co-operation and Development, Social Impact Investing: Building the Evidence Base (January 2015) (SMIM).

David Brooks, How to Make a Mark, *New York Times* (January 27, 2015).

Robert Milburn, How Impact Philanthropy is Shape-Shifting, *Barrons* (March 6, 2015).

Jed Emerson, The Metrics Myth, *Blended Value* (February 10, 2015)

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Participants

Carly Abrahamson - Colorado Impact Fund, Principal and General Counsel
Steve Bachar - Ireland Stapleton and Empowerment Capital, Partner, Founder
Greg Barry - Impact Hub Boulder, Entrepreneur In Residence
Kim Coupounas - B-Lab, Colorado Director
Jill Dupre - ATLAS, Associate Director
Jed Emerson - Colorado Impact Fund; Gary Community; Community Funds, Senior Advisor
Erik Gerding - Colorado Law, Professor
Stephanie Gripne - Impact Finance Center, Executive Director
Andrea Guendelman - Colorado Law, Adjunct Professor
Rehan Hasan - Hasan Legal, Partner
David Haynes - Greenmont Capital, Managing Director
Rebecca Jackson - "After Wall Street": Reinvention Guide for Individuals, Founder
Andrew Kassoy - B Lab, Founder
Shalyn Kettering - Colorado Law, Student
Ryan Kilpatric - Colorado Impact Fund, Partner
Shannon Liston - Colorado Law, Student
Herrick Lidstone - Strum College of Law, Professor
Mark Loewenstein - Colorado Law, Professor
Monisha Merchant - Lotus Advisory Ltd., Managing Director
Jonathan Milogram - Colorado Law, Student
Scott Peppet - Colorado Law, Professor
Walt Pounds - Solbourne Computers, President
Trish Rogers - Moye White, Vice Chair – Business Section
Ashton Seip - Colorado Law, Student
Dominick Sekich - Moye White LLP, Vice-Chair
Nancy Stevens - First Western Trust, Chairman
Paul Tosetti - Nurse Family Partnerships, Chief Financial Officer
Adrian Tuck - Tendrill, Chief Executive Officer
Jamie Van Leeuwn - Governor's Office, Senior Advisor
Doug Vilsak - Posner Center, Executive Director
Taber Ward - Mountain Flower Dairy, Executive Director
Phil Weiser - Colorado Law, Dean
Ken Weil - Social Impact Solutions, Principal
Brett Wilhelm - Ptera Capital Management, Managing Member

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Article

Business Law[a1]

THE LONG AND WINDING ROAD TO PUBLIC BENEFIT CORPORATIONS IN COLORADO

Herrick K. Lidstone, Jr.[a2]

This article discusses the Public Benefit Corporation Act (PBCA) of Colorado adopted by the 2013 Colorado General Assembly. The PBCA allows for-profit corporations to elect to consider other motives beyond the pure profit motive, and protects the decision-making process of directors and management when so doing.

In 2013, the Colorado General Assembly enacted and in May 2013 Governor John Hickenlooper signed HB 13-1138, the “Public Benefit Corporation Act of Colorado” (PBCA). The bill was sponsored by Rep. Pete Lee (D. El Paso County) and Sen. John Kefalas (D. Larimer County). The PBCA adds Part 5 to Article 101 of the Colorado Business Corporation Act in Title 7, CRS, to allow Colorado corporations desiring to do so to elect the status of being a “public benefit corporation.” A public benefit corporation (PBC) must identify a public benefit purpose in its articles of incorporation, and the directors, in managing the business and affairs of the PBC, must balance the pecuniary interests of the shareholders, the interests of those materially affected by the corporation's conduct, and the public benefits identified in the articles of incorporation.

As explained below, Colorado's PBC statute has little similarity to the other benefit corporation statutes adopted or being considered in a number of other states[1] or the “model benefit corporation act” proposed by B Lab Company of Berwyn, Pennsylvania (B Lab and the B Lab model act[2]). The PBCA becomes effective April 1, 2014.

PBCs in Colorado

The Drafting Group believes that the PBCA enacted in Colorado is a significant step forward in the national dialogue regarding benefit corporations. It provides a mechanism by which a business corporation organized under the Colorado Business Corporation Act (CBCA) or a cooperative organized under Articles 55 or 56 of Title 7, CRS, can elect to become a PBC by a two-thirds vote.[3] The remaining one-third has the right to dissent under CRS § 7-113-101 if they choose to exercise that right.[4] To make this right to dissent clear, amendments were adopted to § 7-113-102(1) by adding subsections (1)(e) (which incorporates the right to dissent found in CRS § 7-101-504(3)) and (1)(f) (creating a right to dissent if a PBC completes a plan by which it terminates its status as a PBC).[5] Furthermore, a nonprofit corporation cannot be a constituent entity in a conversion to PBC status.[6]

PBC Defined

A public benefit corporation is defined as one that "is intended to produce a public benefit or public benefits and to operate in a responsible and sustainable manner." [7] The articles of incorporation will serve as the basis for disclosure by the PBC. For a corporation to be a PBC:

1) the articles of incorporation must set forth one or more specific public benefits to be promoted by the PBC; [8]

2) the articles of incorporation must state at the beginning that the entity is a PBC; [9]

***40** 3) the entity's name must include the words "public benefit corporation" or the abbreviations "P.B.C." or "PBC"; [10] and

4) share certificates issued for a PBC, or the statement required under CRS § 7-106-207, must clearly indicate that the entity is a PBC. [11]

The term "public benefit" is defined to mean: One or more positive effects or reduction of negative effects on one or more categories of persons, entities, communities, or interests other than shareholders in their capacities as shareholders, including effects of an artistic, charitable, cultural, economic, educational, environmental, literary, medical, religious, scientific, or technological nature. [12]

Importantly, the PBCA does not impose the potentially contradictory requirements of the "general public benefit purpose" mandated by the B Lab model act, but provides the flexibility to the shareholders to define the other-than-profit purpose or purposes of the PBC.

The PBCA makes it clear that the PBC statute does not create a negative implication against other CBCA corporations that may want to adopt some level of corporate social responsibility as defined by the shareholders for marketing or other purposes. [13]

To the extent that any Colorado corporation can elect in its articles (or by resolution or otherwise) to follow a beneficial purpose outside a pure profit motive and protect the business judgment of its directors before the enactment of the PBCA, a Colorado corporation can continue to do so without electing to be treated as a PBC. [14]

The Directors' Standard of Conduct

The PBCA defines the "duties of directors" as follows:

> The Board of Directors shall manage or direct the business and affairs of a public benefit corporation in a manner that balances the pecuniary interests of the shareholders, the best interests of those materially affected by the corporations conduct, and the specific public benefit identified in its articles of incorporation. [15]

Under this provision, the board of directors must balance the pecuniary interests of the shareholders and the specific public benefit the shareholders have defined with "the best interests of those materially affected by the corporation's conduct."This could include employees, suppliers, and customers, but also could include neighbors and even competitors.

● This does not include the mandatory "consideration" of potentially conflicting factors as does the B Lab model bill, but does suggest careful drafting of board of directors' minutes to reflect the "balancing" mandated by the statute.

● The PBCA does not provide for any prioritization of the balancing requirement. [16] The articles of incorporation, which must set forth the public benefits, may address the shareholders' desires with respect to prioritization of the balancing requirement. This may include prioritizing one group of constituencies over others (as described in the footnote). [17] Any statement in a PBC's articles of incorporation as to priorities will provide further transparency to the board's decision making.

This provision expands the focus of the PBC beyond the "best interests of the corporation," as required by CRS § 7-108-401(1). Unlike the B Lab model act, this balancing does not mandate any conclusion, although the shareholders can provide further direction in the PBC's articles of incorporation.

The legislation provides that directors shall not have any duty to any person, because that person may have an interest in the PBC's identified public benefit. The PCBA also provides that where directors perform the balancing of interests described above, they will be deemed to have satisfied their fiduciary duties to shareholders and the corporation if their "decision is both informed and disinterested and not such that no person of ordinary, sound judgment would approve." [18] This is an effort to establish a very high threshold for plaintiff shareholders who may want to challenge directorial action. In addition, the PBC's articles of incorporation may (and should) provide that a failure by any disinterested director to satisfy the requirements of CRS § 7-101-506 "does not, for the purposes of section 7-108-401 or article 109 [of the CBCA] constitute an act or omission not in good faith or a breach [of the director's] duty of loyalty." [19]

This is similar to--but in addition to--the exoneration provision found in CRS § 7-108-402. That provision eliminates a director's liability for monetary damages for breach of his or her duty of care, but not for a breach of the duty of loyalty. [20]

In the end, this balancing requirement is the price that a PBC must pay for the statutory protections afforded to directors of a PBC. If a corporation does not want to balance the interests of its shareholders against "the best interests of those materially affected by the corporation's conduct," choosing to be a PBC would be illadvised.

Reporting Requirements

The Delaware legislation [21] from which the PBCA was derived required that the PBC deliver a biennial report to shareholders that permitted, but did not require, assessment against a third-party standard. In negotiations that led to the finalization of the PBCA as adopted, the proponents of the B Lab model act asked that the reporting provisions included in the prior version of HB 13-1138 be carried forward in the new version. As a result, there is no mandatory annual or biennial reporting period, but merely a requirement that the PBC "prepare a report" that includes certain information. The report (when prepared) must describe:

***41** 1) the ways in which the PBC promoted the public benefit identified in the PBC's articles of incorporation and the best interests of those materially affected by the PBC's conduct; [22]

2) any circumstances that have hindered the PBC's promotion of the public interest identified in its articles of incorporation or the best interests of those materially affected by the PBC's conduct, [23]

3) the process and rationale for selecting or changing any third-party standard against which the PBC's performance is assessed; [24] and

4) an assessment of the overall social and environmental performance of the PBC against a third-party standard, although the assessment can be a self-assessment and does not need to be audited or certified by any third party. [25]

Each PBC must send a copy of the report (when prepared) to each shareholder [26] and post it on the PBC's website. The posted version of the report may omit financial or proprietary information included in the report sent to shareholders. [27] If the PBC does not maintain a website, it must provide the report (free of charge) to any person requesting a copy. [28]

The Third-Party Standard

There is no mandate in the PBCA that any PBC actually select a third-party standard. However, the implication in the reporting section is clear that, when a report is prepared, the report should include an assessment against a third-party standard. The term "third-party standard" is defined as a "standard for defining, reporting, and assessing the overall corporate social and environmental performance" that has been "developed by an organization that is not controlled by the [PBC] or any of its affiliates." [29] The definition also requires that the publisher of the standard make publicly available:
1) the criteria considered when measuring the social and environmental performance of a business, the relative weightings of those criteria, if any, and the process for development and revision of the standard; and

2) the "material owners" of the organization, the members of its governing body (and their selection process), and the sources of financial support for the organization "in sufficient detail to disclose any relationships that could reasonably be considered to compromise its independence." [30]

There is no penalty for failing to include an assessment, and (in contrast to the other acts) the PBCA imposes no temporal requirement for the benefit report (annual as in the B Lab model act [31] or biennial as in the Delaware legislation [32]). Because the CBCA requires an annual meeting of its shareholders, [33] that would be the appropriate time for the benefit report to be prepared. Theoretically, a PBC could ignore the assessment and the benefit report requirements without penalty, although subject to risk of shareholder action.

Enforcement Issues

Shareholders of a PBC may enforce the directors duties under CRS § 7-101-506(1) [34] through a derivative action [35] if the shareholders ***42** (individually or collectively) own at least 2% of the PBC's outstanding shares or (if a public corporation listed on a national securities exchange) the lesser of 2% or shares with a value of at least $1 million. [36]

This is the only right that the PBCA permits the shareholders to enforce by a derivative action. There is nothing in the PBCA that takes away the right of any other shareholder in a Colorado corporation (including a PBC) to maintain a derivative action outside the PBCA except to the extent that a shareholder of a PBC is demanding that the directors focus only on the shareholders' pecuniary interests. The right to bring such an action is limited because that is the focus of the PBCA. Persons other than shareholders of a PBC do not have the right to bring a derivative action (or any other enforcement action) under the PBCA. [37]

It should be noted that the derivative action provision found in CRS § 7-101-508 has an antecedent existing in the CBCA at § 7-107-402 (entitled Actions by Shareholders). This applies to both PBCs and corporations formed under the CBCA that are not PBCs. Section 7-107-402 further defines the right of shareholders to bring derivative actions. Nothing in the PBCA changes the application of that provision except to the extent that § 7-101-508 changes the standing issue for a derivative action brought against a PBC, [38] but limits those actions to an enforcement of the directors' duties under §7-101-506(1).

In balancing the factors as required by § 7-101-506(1) of the PBCA, the directors are protected from frivolous litigation in a couple of ways. First, § 7-101-506(2) provides that a director of a PBC does not have any duty to any beneficiary of the identified public benefit or other person because of an interest "materially affected by the [PBC's] conduct." [39] Second, the PBCA goes on to say that, with respect to any decision implicating the balancing requirement, the directors will have satisfied their duties:

> to the shareholders and the corporation if the director's decision is both informed and disinterested and not such that no person of ordinary, sound judgment, would approve. [40]

This latter clause is interesting in two respects. First, for the protection to be available, the director raising the defense must be disinterested with respect to the decision. Second, the double negative in the last part of the clause raises the complaining shareholder's burden of proof significantly unless the complaining shareholder can show that the director was not disinterested with respect to the decision. [41] It remains to be seen whether this disinterestedness requirement adversely impacts the willingness of directors to make decisions, or increases the disclosure of potential conflicts of interest. [42]

Provisions in the B Lab Model Act Not Included in the PBCA

Several earlier pieces of legislation introduced into the Colorado General Assembly were based on the B Lab model act, which the Drafting Group found to be deficient. As enacted, the PBCA differs from the B Lab model act in a number of significant respects.

No General Public Benefit Mandate

The most significant difference between the B Lab model act and the PBCA is the B Lab model act's requirement that every benefit corporation create a general public benefit defined to be "a material positive impact on society and the environment, taken as a whole, assessed against" a third-party standard. [43] The Drafting Group believed that "environment" is truly a subset of ""society," and that things good for society may not necessarily be good for the environment. Thus the B Lab model act requirement was internally inconsistent and contradictory.

The Drafting Group believed that when shareholders expressed a specific public benefit in the PBC's articles of incorporation, it was important to the shareholders. Under the B Lab model act, however, any specific public benefit identified by the shareholders was secondary to the general public benefit as defined by the B Lab model act. The Drafting Group believed that the PBCA's balancing requirement in § 7-101-506(1) was more appropriate for the desired operation of a PBCA and more consistent with the board of directors' normal methods of operation. Furthermore, the focus on the specific public benefits was, in the Drafting Group's opinion, more likely to achieve the shareholders' goals. As such, the PBCA appeared to be more closely aligned with the original intention of the Drafting Group for flexibility than with the B Lab model act's structure.

No Benefit Director Mandate

The B Lab model act requires that benefit corporations that are publicly traded must, and other benefit corporations may, appoint a benefit director who has certain obligations that differ from the other directors.[44] In addition to being a member of the board, the benefit director must prepare an ""annual compliance statement" that offers the benefit director's opinion whether the benefit corporation "acted in accordance with its general public benefit purpose ***43** and any specific public benefit purpose in all material respects during the period covered by the report."[45] The B Lab model act exonerates the benefit director from any personal liability unless the liability derives from self-dealing, willful misconduct, or a knowing violation of law.[46] The Drafting Group believed that including a director with a special constituency different from the other directors was inadvisable and inconsistent with Colorado law.

No Benefit Officer

The B Lab model act contemplates the possibility that benefit corporations may appoint a "benefit officer"[47] and establishes standards of conduct for officers generally.[48] The Drafting Group believed that the standards of conduct for officers with discretionary authority found in CRS § 7-108-401(1) was sufficient and there did not need to be a special provision for officers of a PBC.

No Attempt to Redefine a Derivative Action

The B Lab model act provides that a "benefit enforcement action" may be brought against the board by the benefit corporation itself.[49] The Drafting Group did not see the value in this provision because it is the board of directors who would make the determination for the benefit corporation to bring the action.

The B Lab model act provides that a "benefit enforcement action" may be brought derivatively by persons other than shareholders.[50] The Drafting Group was concerned about the use of the term "derivatively," which has a very clear meaning in the law and the interpretation of which is tied to Rule 23.1 of the Federal and Colorado Rules of Civil Procedure. It is clear in the CBCA[51] and in Rule 23.1[52] that only equity owners can bring a derivative action, and the right to do so does not extend to directors, owners of an affiliated entity, and "other persons."

Rather than attempting to redefine a derivative action, in original HB 13-1138, the Drafting Group included a provision as follows:

> A benefit enforcement proceeding may be commenced or maintained only: ... (b) by other persons as specified in, and pursuant to the procedures that must be specified in, the articles of incorporation of the benefit corporation.[53]

The Drafting Group also included other provisions that tied the benefit enforcement proceeding contemplated by the original HB 13-1138 more closely to existing Colorado law, including:

1) requiring that any benefit enforcement proceeding brought by a shareholder be brought pursuant to CRS § 7-107-402;[54] and

2) making it clear that the rights to bring a benefit enforcement proceeding did not limit any persons rights to commence or maintain an action under CRS § 7-103-104 or § 7-114-301.[55]

These provisions are not included in the PBCA, but may be considered for future amendments.

Exoneration of Directors

Under the B Lab model act [56] and the original HB 13-1138, [57] there was a clear exoneration of the corporation and its officers and directors of liability for monetary damages if they met the applicable standard of care. There is no similar provision under the PBCA; there is merely the provision discussed above that the PBC's articles of incorporation may provide that a failure by any disinterested director to satisfy the requirements of CRS § 7-101-506
does not, for the purposes of section 7-108-401 or article 109 [of the CBCA], constitute an act or omission not in good faith or a breach [of the director's] duty of loyalty. [58]
The term “disinterested” is not defined and this leaves room for interpretation. This, again, is a provision that may be looked at for further amendment.

Cooperatives May Elect PBC Status

One provision in the PBCA that is not included in either the Delaware legislation from which the PBCA was adapted or the B Lab model act is that the PBCA includes the right for certain cooperatives organized under Articles 55 or 56 of Title 7, CRS, to elect PBC status. [59]

Why a PBC Rather Than a Non-PBC

As noted above, there is a school of thought that a PBC is necessary because a regular corporation cannot protect its directors when making decisions that may intentionally reduce profit or positive cash flow, or otherwise have no direct correlation to the success of the corporation's business. Of course, the business judgment rule [60] serves to protect directors when they make a bad business judgment provided the directors did so in good faith and after a reasonable investigation and did not violate their duty of loyalty. That is not the type of decision in question. The decision for which the PBC may be useful to protect directors is the intentional decision by the directors to divert some of the corporation's profit or cash flow to purposes that may have a socially beneficial effect (at least in the opinion of the shareholders), which has no demonstrable positive impact (marketing or otherwise) to the corporation itself. [61] In effect, the directors are intentionally diverting cash resources that could be used for the benefit of the business or as a distribution to the shareholders to a non-business purpose. Such an action likely would not be protected by the customary interpretations of the business judgment rule.

It is, of course, possible that the articles of incorporation of a CBCA corporation can include, among its stated purposes, a non-business purpose. The articles also can include an instruction to the directors that, in pursuing the purposes of the corporation, they are to include in their decision making this other non-business purpose even at the expense of business profit and business opportunities. This is consistent with the view of Professor Celia Taylor, University of Denver Sturm College of Law, who has said:

> I continue to believe that special legal designation of benefit status is not necessary. In time, empirical analysis may be able to establish whether the new legislation in Delaware and elsewhere makes any

> meaningful difference in corporate behavior or whether it simply provides another avenue for corporations to tout their “good” behavior. [62]

Professor Taylor is correct when discussing board considerations in connection with a takeover bid. In *Unocal Corp. v. Mesa Petroleum Co.*, [63] the Delaware Supreme Court said that in reaching its conclusion whether to support the takeover bid, the target board of directors may consider “the impact [of the bid] on ‘constituencies' other than shareholders (*i.e.*, creditors, customers, employees, and perhaps even the community generally.)” On the other hand, the law in Colorado and other states supporting that approach outside the limited *Unocal* context is uncertain. [64] Furthermore, it is ***44** important to note that the PBC and the benefit corporation are designed to do more than simply support a corporations view of social responsibility and beneficial causes. Under the B Lab model act, every benefit corporation must pursue or create the general benefit purpose, which is defined as follows:

> A material positive impact on society and the environment, taken as a whole, assessed against a third-party standard, from the business and operations of a benefit corporation. [65]

This requires that the directors of the benefit corporation look beyond any specific benefit purposes identified in the benefit corporation's articles of incorporation. [66]

This is similarly the case with the PBCA. Unlike the B Lab model act, the PBCA does not require that the PBC pursue or create the general public benefit. Also unlike the B Lab model act, the PBCA requires that the PBC pursue or create one or more specific public benefits that are to be described in its articles of incorporation. [67] However, the PBCA makes it clear that pursuing the identified specific public benefits at the expense of profit is not sufficient. As described above, the PBCA provides that (in their decision making) the directors must balance: [68]

1) the pecuniary interests of the shareholders (usually defined as “ “profit”);

2) the specific public benefit identified by the PBC in its articles of incorporation; and

3) the best interests of those materially affected by the corporation's conduct.

The third factor requires the directors to look beyond the PBC itself in their decision making and is the most significant distinction between a CBCA corporation that has added provisions to its articles of incorporation and a PBC.

This third factor will require significant future interpretation and at present leads to potential uncertainty. For example, competitors of the PBC are potentially “materially affected by the corporation's conduct” and therefore should be considered by the directors in balancing the factors in the decision-making process.

It should be noted that the PBCA does not require any specific decision as a result of the directors' balancing or that the directors give greater weight to one factor over other factors. Of course, the shareholders could draft the PBC's articles of incorporation to be more specific or to give more weight to certain factors as compared to others.

Corporations are inherently formalistic. To comply with corporate formalities, decisions of the board of directors should be documented. When documenting decisions of a PBC, corporate counsel or the corporate secretary should reflect the balancing accomplished by the board members for each decision. Whether this can be a simple statement (such as "the directors approved the following resolutions after balancing the factors set forth in CRS § 7-101-506(1)") or must be a more detailed statement initially will be up to the board members themselves. It will be important to reflect the balancing action to defend the decision if challenged.

Greenwashing

As explained by J. William Callison, [69] B Lab and others believe that the unregulated nature of the "benefit corporation" poses a serious problem that corporations may "greenwash" for-profit activities under the benefit corporation label, unless state statutes provide strong and consistent regulation in the B Lab format. B Lab apparently is concerned that corporations will flock to obtain a benefit corporation label for their own marketing purposes, with little desire to actually accomplish the general or any specific public benefit.

This argument must be understood in the context that none of the benefit corporation statements provides any accountability to any person other than shareholders. Under the B Lab model act, the original Colorado bill proposal, and the other acts that have been adopted nationally, there is little required of a benefit corporation (or in Colorado's and Delaware's case, a PBC) to avoid greenwashing. Corporations electing PBC or benefit corporation status and then failing to pursue or create their designated public benefit purposes are still able to use the PBC or benefit corporation moniker, because there is no public enforcement that the PBC or benefit corporation actually pursue their designated public benefit purposes, whether to provide a "material positive impact on society and environment" or a more limited purpose. Furthermore, there is no requirement that a corporation cease using the PBC or the benefit corporation designation if it falls out of the described mandate.

The self-assessment requirement of the Colorado act and the B Lab model act do not provide any significant protection from greenwashing because the assessment is a "self-assessment" that does not need to be audited or verified by any third party. Ultimately, the shareholders and others who are relying on the requirements of the PBCA or any benefit corporation act must rely on the integrity of the board of directors--as must the shareholders of all corporations.

Under the PBCA, the B Lab model act, and the acts adopted in other states, there is merely a reporting requirement: that the PBC or benefit corporation report the accomplishment of its purposes to its shareholders and by posting the report on the publicly available portion of its website. Shareholders can demand the report and can bring a derivative action (or "benefit enforcement proceeding" in the B Lab model act) to enforce the public benefit purpose. [70] Where shareholders see the profit potential from the PBC or benefit corporation designation, they may not want to do so if they believe that the marketing value of the PBC or benefit corporation status enhances that profit potential.

***45** Thus, to the extent greenwashing may be an issue, no form of PBC or benefit corporation legislation resolves that problem. Furthermore, the issue of greenwashing necessarily carries the assumption that the third parties desiring to invest in or otherwise do business with the PBC or benefit corporation will fail to perform any due diligence on the PBC or benefit corporation and the performance by it of its public benefit obligations. One can question that where a person (investor, customer, or supplier) considers the social consciousness of a PBC or benefit corporation to be important, that person really will proceed to deal with or invest in a socalled PBC or benefit corporation with no understanding of what the PBC or benefit corporation is actually accomplishing. Where benefit performance is important, any interested person who merely relies on the statements by the PBC or benefit corporation or its principals leaves room for misunderstanding or fraud.

Unanswered Questions

There are a number of other unresolved issues facing corporations that elect to become PBCs under Colorado law or benefit corporations under the laws of other states. These are discussed below.

The Colorado Securities Act

The PBCA does not address issues under the Colorado Securities Act,[71] which regulates offers and sales of securities in Colorado. Generally, compliance will require disclosure to prospective investors of the public benefit purpose so that investors are not misled into believing that the PBC is a CBCA entity with a pure profit motive and the directors' duty of care obligations under CRS § 7-108-401(1) "for the best interests of the corporation." Other normal compliance with the exemption/registration requirements of the Colorado Securities Act and the licensing of broker-dealers is also required. If a PBC (or a benefit corporation organized under the laws of another state) solicits funds from investors, it will need to consider the applicability of federal and state laws regulating the offer and sale of securities.

The Colorado Charitable Solicitations Act

The PBCA also does not address issues that may arise for PBCs under the Colorado Charitable Solicitations Act.[72] The Colorado Charitable Solicitations Act was enacted "to protect the public's interest in making informed choices as to which charitable causes should be supported" and "to help the secretary of state investigate allegations of wrongdoing in charities, without having a chilling effect on donors who wish to give anonymously or requiring public disclosure of confidential information about charities." The Charitable Solicitations Act requires that "charitable organizations"[73] and other persons who solicit[74] donations file certain reports with the Colorado Secretary of State. A PBCs public benefit purpose may fit within the broad definition of a "charitable purpose" and, as a result, the PBC may be considered to be a charitable organization. If soliciting funds for its public benefit purpose, each PBC should consider whether compliance with the Charitable Solicitations Act is required and how to accomplish such compliance.[75]

Note that the potential application of the Charitable Solicitations Act is not a problem that was unique to the PBCA. Limited liability companies (LLCs) can be formed in Colorado to conduct "any lawful business"[76] whether or not for a profit. An LLC can have a hybrid (public benefit or charitable) purpose even if it also is engaged in a business for a profit. As a result, there is a risk that any LLC (like any PBC or other person) who solicits funds for a charitable organization or a charitable purpose thereby would become subject to the Charitable Solicitations Act.

The Internal Revenue Code

The Colorado legislation, and legislation for benefit corporations generally, does not and cannot address the many issues that may arise under the Internal Revenue Code (Code) for a PBC pursuing its public benefit purpose. For example, § 162(a) of the Code authorizes taxpayers to deduct from income their ""ordinary and necessary business expenses." Marketing expenses generally fall within this section, such as the expenses incurred in advertising "organically grown ingredients," "sustainably grown coffee," or "contributions to local schools or charities."Will expenditures for a public benefit purpose that do not fit within the marketing rubric or that may be excessive when compared to normal marketing budgets be deductible? That is a question to be answered.[77]

ERISA

The PBC may be a wholly unsuitable investment for an employee stock ownership plan (ESOP) or other plan governed by the Employee Retirement Income Security Act of 1974 (ERISA).[78] The primary responsibility of fiduciaries of an ERISA plan is to run the plan solely in the interests of the participants and beneficiaries, and for the exclusive purpose of providing benefits and paying plan expenses.[79] B Lab states that the focus of a benefit corporation is not profit, but rather the "triple bottom line."[80] *The Economist* describes the "triple bottom line" as follows, with only one of the three focuses of the entity seeking the triple bottom line being profit:

> The phrase "the triple bottom line" was first coined in 1994 by John Elkington, the founder of a British consultancy called SustainAbility. His argument was that companies should be preparing three different (and quite separate) bottom lines. One is the traditional measure of corporate profit-- the "bottom line" of the profit and loss account. The second is the bottom line of a company's "people account"--a measure in some shape or form of how socially responsible an organization has been throughout its operations. The third is the bottom line of the company's "planet" account--a measure of how environmentally responsible ***46** it has been. The triple bottom line (TBL) thus consists of three Ps: profit, people and planet.[81]

What fiduciary will be able to conclude that a PBC or benefit corporation that is not being operated solely for profit or the pecuniary benefit of its shareholders meets the mandated ERISA fiduciary standard of care? Any decision by an ERISA fiduciary to invest in or hold securities of a PBC or a benefit corporation (or any corporation claiming a purpose other than profit) may be a personally risky decision to the fiduciary under current law.

Applicability of the PBC

Properly used, it can be expected that PBCs and benefit corporations will have limited utility. William H. Clark has predicted that "[f]or-profit social entrepreneurship, social investing and the sustainable business movement have reached a critical mass."[82] Similar arguments were made before the Colorado General Assembly in 2012 and 2013, and in the 2013 Senate floor debate, Senator Rollie Heath (D. Boulder) said that he had received communications from a large number of companies with potentially S500 million in revenues and "thousands of jobs" that were ready to be PBCs.[83] Whether this is fact or hyperbole remains to be seen.

On the other hand, reaction to the April 24, 2013 collapse of the garment factory building in Bangladesh, where more than 1,100 people were killed, shows that people care about social good. That came on the heels of a fire at another factory in November 2012 that killed 112 low-wage workers. Factories like these in Bangladesh pump out what author Elizabeth Cline calls ""fast fashion"--clothes made for and sold inexpensively by big chain stores. Whether these stores suffer any long-term repercussions for these incidents and the working conditions in their Asian garment factories generally remains to be seen.[84] Will the public care about how and where their clothes are made, or will price continue to be the driving factor?

Clearly, retailers--large and small--have focused on "doing good" and making that known publicly for marketing purposes. This is the focus of organizations such as the PIER Institute, which is a U.S. 501(c)(3) organization designed "to ... support policy initiatives aligned with free market reforms, greater respect for individual rights and the rule of law, and a commitment to corporate social responsibility."[85] As discussed above, no company needs to be a PBC or a benefit corporation to do so.

Furthermore, the certification organizations, such as B Lab Company, have certified a number of corporations and other entities that are not benefit corporations or PBCs.[86] So, what corporation may want to be a PBC or a benefit corporation?

B Lab and others believe that simply being known as a benefit corporation or a PBC has value. We will have to see whether this is the case, or whether the value will be in the entity's performance--is it selling or using low-cost merchandise made in inhumane conditions not withstanding its purported social mission? Can any self-assessment not audited by an independent third party ever get to the bottom of that question?[87]

There undoubtedly are businessmen and businesswomen who truly want to see their organization do better for the world or for their community while making a profit. They may want to see their vision ingrained into the fiber of the corporation so that the vision survives the individual.[88] It is for this purpose that a benefit corporation or a PBC may have value.

● By being a benefit corporation, the corporation's directors are obligated to pursue or create the "general public benefit" "to create a material positive impact on society and the environment" in addition to any specific public benefit identified in the benefit corporation's articles of incorporation.

● By being a PBC, the corporations directors are obligated to balance the interests of those materially affected by the corporation's conduct with the pecuniary interests of the shareholders and the public benefits identified in the articles of incorporation.

● By being a PBC, the directors are obligated to operate the PBC in a "responsible and sustainable manner."[89] These are, however, goals applicable not only to PBCs but to all corporations and, in fact, to all business entities.[90] To the extent there is any difference, the PBC directive clearly mandates that the PBC managers look to the longer term rather than shorter term results.[91]

In this light, is there a place for PBCs? The answer is a cautious "yes." Successful business professionals may want to see their vision survive their tenure. Where the balancing requirements of the PBCA (or the general public benefit requirement of the B Lab model act and its progeny) fit the entrepreneur's vision, the relevant act may form a reasonable basis for incorporation or adoption. It must be done carefully and after a consideration of relevant factors and directors' duties and in light of the shareholders' needs and desires. Finally, and perhaps most important, becoming a PBC or a benefit corporation is not an "out-of-the-box" activity. It requires careful drafting of articles of incorporation and consideration of other factors, including designating priorities for the directors to consider and assigning weight to the various factors to be balanced.

In the end, shareholders still will have the right to abandon PBC or benefit corporation status. Furthermore, only shareholders truly have the right to enforce PBC or benefit corporation activities. Under a regular corporation and under a PBC or benefit corporation, it remains up to the shareholders to ensure that the directors and management act as the business judgment rule, as modified by the PBCA or the Model Benefit Corporation Act (or its progeny), requires.

Conclusion

The PBCA, enabling PBCs, is the product of compromise and therefore is imperfect in the eyes of the Drafting Group, as well as the proponents of the B Lab model act. It is the product of several years of work by the Drafting Group seeking to create a statute for Colorado that protected directors when following public benefit direction from the shareholders but did not put the corporation and its shareholders in the inflexible handcuffs of the B Lab model act as adopted in a number of states. It is unlikely that the PBC legislation or any benefit corporation legislation will provide a panacea for the socially responsible business movement. It will, however, put another arrow in its quiver.

Footnotes

a1 Business Law articles are sponsored by the CBA Business Law Section to apprise members of current substantive law. Articles focus on business law topics for the Colorado practitioner, including antitrust, bankruptcy, business entities, commercial law, corporate counsel, financial institutions, franchising, and securities law.

a2 Herrick K. Lidstone, Jr. is managing director and a shareholder of the Greenwood Village law firm of Bums, Figa & Will, P.C. He practices in transactional law, including corporations, limited liability companies, financing, mergers and acquisitions, and ethics--(303) 796-2626, hklidstone @bfwlaw.com. The author thanks all of the members of the Drafting Group, who provided very valuable discussion, analysis, and humor throughout the entire ""Long and Winding Road." The Drafting Group comprised many attorneys over time, but the following (in alphabetical order) were consistent participants: William Callison, John deBruyn, Robert Keatinge, Cathy Krendl, Herrick Lidstone, Avi Loewenstein, Mark Loewenstein, John Moye, Todd Olinger, Michael Sabian, Allen Sparkman, Sarah Steinbeck, Beat Steiner, Celia Taylor, and Anthony van Westrum. The assistance of the CBA lobbyists, Michael Valdez and Amy Redfem, were invaluable in the efforts to adopt HB 13-1138. An expanded version of this article is available online through the Social Science Research Network at ssrn.com/abstract=2266654. This article was edited by Trygve E. Kjellsen, who passed away in November 2013.
Coordinating Editors
David P. Steigerwald of Sparks Willson Borges Brandt & Johnson, P.C., Colorado Springs--(719) 475-0097, dpsteig@sparkswillson.com; Curt Todd, Denver--(303) 955-1184, ctodd@templelaw.comcastbiz.net (Bankruptcy Law)

1 According to information available at www.bcorporation.net, eighteen states have adopted benefit corporation statutes based on the B Lab model act, while Colorado and Delaware have adopted legislation in a significantly different form. *See* Callison, "Benefit Corporations, Innovation and Statutory Design" 19 (Aug. 12, 2013), available at www.ssrn.com/abstract=2308941 (contrast of the Colorado/Delaware approach to benefit corporation legislation to the B Lab model act and HB 13-1138 as originally proposed in the 2013 Colorado General Assembly).

2 B Lab, Model Benefit Corporation Legislation, available at www.benefitcorp.net/storage/documents/Model_Benefit_Corporation_ Legislation.pdf. For a discussion of many deficiencies in the B Lab model act, *see generally* Loewenstein, "Benefit Corporations: A Challenge In Corporate Governance," 68 *The Business Lawyer* 1007 (Aug. 2013). Additionally, the Corporate Laws Committee of the American Bar Association has recently issued the "Benefit Corporation White Paper," 68 *The Business Lawyer* 1083 (Aug. 2013). This includes an appendix A, which proposes the addition of chapter 18 to the Model Business Corporation Art to permit the formation of "public benefit corporations" as a for-profit corporation "intended to operate in a responsible and sustainable manner, to produce a public benefit or benefits ... and to otherwise operate in a manner that considers the interests of those materially affected by its conduct." Proposed § 18.01(2) of the Model Business Corporation Act, in "Benefit Corporation White Paper" at 1095.

3 The Delaware General Corporation Law (DGCL), § 363(a), requires a 90% vote.

4 CRS § 7-101-504(3).

5 HB 13-1138, §2.

6 CRS § 7-101-504(5). Even the prohibition contained in § 504(5) does not prevent a nonprofit from giving up its nonprofit status and becoming a public benefit corporation (PBC); it will simply require a twostep process. First, the nonprofit will convert into a Colorado Business Corporation Act (CBCA) corporation (or to a limited liability company (LLC) or other entity). Second, the resulting CBCA corporation (or other entity) may then elect PBC status pursuant to § 7-101-504. There are many issues involved with such a conversion, but that has nothing to do with the PBC status but with the initial nonprofit status. For example, the conversion of "member" to "shareholder" has to address the different attributes of each. (*Compare* CRS §§ 7-107-101 *et seq.* *with* CRS §§

7-126-101 *et seq.*) The conversion of the "nonprofit" purpose to a "profit" purpose and the removal of the "no distributions" restriction of the nonprofit in CRS § 7-133-101 are other issues the nonprofit leaving that status must consider. In some cases, the nonprofit must transfer its assets to another nonprofit before it can elect a status other than that of a nonprofit **corporation**. These may be complicated issues under the Internal Revenue Code and the Treasury Regulations.

7 CRS § 7-101-503(1). The American Bar Association (ABA) Model Business **Corporation** Act allocates control of a **corporation** to the directors, as does the CBCA. In doing so, the ABA Committee on **Corporate** Laws explains that the goal is not to have directors looking over their shoulders at shareholders, the result of which would be that "the time and attention of managers could, in many cases, be diverted from activities designed to pursue sustainable economic **benefit** for the **corporation**." Committee on **Corporate** Laws of the ABA Section of Business Law, "Report on the Roles of Boards of Directors and Shareholders of **Publicly** Owned **Corporations**" 5 (2010), available at www.hunton.com/media/SEC_Proxy/PDF/SEC_Agenda_Section2.pdf.

8 CRS§7-101-503(1)(a).

9 CRS§7-101-503(1)(b).

10 CRS § 7-101-503(4). There is no prohibition in the statute that **corporations** that are not PBCs cannot use the "**benefit corporation**" name. In fact, a review of the **Colorado** Secretary of State's website indicates that there are already a number of domestic and foreign **corporations** that include ""**benefit corporation**" in their name. In actuality, the requirement that the name PBC be used is likely to separate these **benefit corporations** from the PBC envisioned by this statute.

11 CRS § 7-101-505.

12 CRS §7-101-503(2).

13 CRS § 7-101-509. This provision states that "This Part 5 does not affect a statute or rule of law that is applicable to a **corporation** that is not a **public benefit corporation**, except as provided in section 7-101-504" (which discusses how existing entities can become a PBC or leave PBC status).

14 Several members of the drafting group believed that the comparable language in HB 13-1138 (pre-amended) more clearly accomplished the same purpose. That language was found in § 7-101-503(2) and in the B Lab model act at § 101(b):

The existence of a provision of this Part 5 does not of itself create any implication that a contrary or different rule of law is or would be applicable to a **corporation** or other entity that is not a **benefit corporation**. This Part 5 does not affect any statute or rule of law as it applies to a **corporation** or other entity that is not a **benefit corporation**.

The language may be considered for a future amendment if determined to more clearly reflect the intention of CRS § 7-101-509.

15 CRS §7-101-506(1).

16 Professor Haskell Murray, in his article "Delaware **Public Benefit Corporations**: Director Guidance," available at socentlaw.com/2013/04/delaware-**public**-**benefit**-**corporations**-director-guidance, cites an article that argues that directors, like all human beings, balance various factors in all decision making. Professor Murray goes on to say:

The fact that humans certainly balance interests of various constituents, however, does not mean that priorities are unimportant. Priorities can help guide and can also provide weightings for the costs and **benefits** of any decision. Also, priorities most clearly help in critical situations. To continue with the work/family example, in a zero-sum game, how does one decide between work and family when the outcome of that decision is of critical importance to both? If an individual has clearly stated that family is a higher priority than work, this critical decision is more easily answered. Even if the priorities are not clearly stated, priorities will still drive the decision. Transparency as to the priorities makes things clearer to all involved and makes it less likely that the individual will drift from his or her true priorities. Similarly, directors would **benefit** from a clear **corporate** objective that includes specific **corporate** priorities.

17 While there are clearly many ways to draft articles of incorporation for a PBC that both identify **public benefits** and establish priorities, consider the following simple example:

The **corporation** will produce a **public benefit** by contributing excess funds (not exceeding legally permitted deductible charitable contributions) to the local theatre group.

> "Excess funds" will be determined by the board of directors in its discretion after taking into account the funds needed and reasonably expected to be needed for future corporate obligations (in excess of expected cash flow), and after the corporation has had earnings of not less than $1.00 per share, of which not less than 25% thereof have been distributed to the shareholders.

In balancing the factors as required by § 7-101-506(1), continuing to operate the corporation in a responsible and sustainable manner will be the most significant priority for the board of directors.

Paragraphs 1 and 2 prioritize the shareholders' pecuniary interest and the public benefit; paragraph 3 prioritizes the continuing operation of the business above all else.

18 CRS §7-101-506(2).

19 CRS § 7-101-506(3). Although the Public Benefit Corporation Act (PBCA) does not state so specifically, presumably the term "disinterested director" (which is not defined in the PBCA) will be interpreted consistently with the "conflicting interest transactions" provisions of the CBCA at CRS §7-108-501.

20 A director's duty of loyalty is frequently implicated when the director (directly or through another person) has interests in the matter that differ from the interests of the corporation, such as in the case of a ""conflicting interest transaction" described in CRS § 7-108-501.

21 The Drafting Group worked from a proposal from the Delaware Bar Association's working group that was later introduced into and adopted by the Delaware legislature, signed by the Delaware Governor on July 17, 2013, and became law effective August 1, 2013. The Delaware act authorizing PBCs amended the DGCL at 8 Del. C. §§ 101 *et seq.* by adding §§361 to 368.

22 CRS§7-101-507(1)(a)(I).

23 CRS § 7-101-507(1)(a)(II).

24 CRS § 7-101-507(1)(a)(III).

25 CRS§7-101-507(1)(b).

26 CRS §7-101-507(2).

27 CRS §7-101-507(3).

28 CRS §7-101-507(4).

29 CRS § 7-101-507(1)(c). In the December 21, 2012 version of the B Lab model act, the definition of "third-party standard" has been simplified but remains complex. B Lab lists eleven third-party standards that it has determined meet the statutory requirements. These include B Lab's own assessment, the Global Reporting Initiative, ISO 26000, and Sustainability Quotient (Underwriters Laboratories), and are listed at www.benefitcorp.net/selecting-a-third-party-standard/list-of-standards.

30 CRS§7-101-507(1)(c).

31 B Lab model act, § 401(a).

32 DGCL, § 366(b).

33 CRS § 7-107-101(1).

34 CRS § 7-101-506(1) requires:

[t]he Board of Directors [to] manage or direct the business and affairs of a public benefit corporation in a manner that balances the pecuniary interests of the shareholders, the best interests of those materially affected by the corporation's conduct, and the specific public benefit identified in its articles of incorporation.

35 The term "derivative action"is used in CRCP 23.1 (entitled Derivative Actions By Shareholders) and is limited to "one or more shareholders or members" of the entity "to enforce the right of a **corporation** or of an unincorporated association." Note that FRCP 23.1 is similar to the **Colorado** rule. There is no standing requirement in either rule except that the plaintiffs be "shareholders or members of a **corporation** or unincorporated association." In bringing a derivative action pursuant to Rule 23.1, the plaintiffs have to follow certain procedural formalities established in Rule 23.1. Nothing in the PBCA changes any of these formalities except for the standing requirement--that the shareholder(s) bringing the action must meet the 2% threshold or $2 million in the case of a **publicly** held and traded **public** **benefit** **corporation**. It should be noted that standing is not addressed in Rule 23.1; it is addressed in CRS 7-107-402(3).

36 CRS § 7-101-507(8). It is hard to imagine a PBC or a **benefit** **corporation** trading on an exchange.

37 The PBCA also provides that directors shall not have any duty to any person solely on account of any interest in the **public** **benefit** and that, where directors perform the balancing of interests described above, they will be deemed to have satisfied their fiduciary duties to shareholders and the **corporation** if their "decision is both informed and disinterested and not such that no person of ordinary, sound judgment would approve." CRS § 7-101-506(2).

38 Under CRS § 7-107-402(3), a shareholder of a **Colorado** **corporation** (in any action other than that brought by a shareholder of a PBC under § 7-101-508) must own at least 5% of the outstanding shares or own shares with a value in excess of $25,000. This is different from the threshold of 2% under § 7-101-508. The lower threshold for actions under § 7-101-508 is arguably warranted by the different character of the entities and the more limited enforcement rights under the PBCA.

39 CRS§7-101-506(2)(a).

40 CRS§7-101-506(2)(b).

41 Only shareholders are entitled to enforce the PBCA against the directors. *See* CRS §§ 7-101-506(2)(a) and -508. The beneficiaries of the identified **public** **benefit** or others "materially affected" are not entitled to bring proceedings against the PBC.

42 The PBCA (CRS § 7-101-506(2)(c)) also provides that the PBC's articles may include a provision that any *disinterested* director's failure to satisfy the standards imposed on directors by § 506 does not constitute an ""omission not in good faith" or "a breach of the duty of loyalty" for the purposes of CRS § 7-108-401 (generally the business judgment rule) or Article 109 (indemnification). (Emphasis supplied.)

43 B Lab model act, §102.

44 B Lab model act, § 302(a).

45 B Lab model act, § 302(c).

46 B Lab model act, § 302(d).

47 B Lab model act, § 304.

48 B Lab model act, §303.

49 B Lab model act, § 305(b)(1).

50 B Lab model act, § 305(b)(2). The B Lab model act contemplated that shareholders of a parent **corporation**, directors, and others named in the articles of incorporation could bring the **benefit** enforcement action ""derivatively."

51 CRS § 7-107-402 provides that "No action shall be commenced by a shareholder in the right of a domestic **corporation**, and no action shall be commenced in this state by a shareholder in the right of a foreign **corporation**, unless the plaintiff" meets certain conditions.

52 CRCP 23.1, entitled Derivative Actions By Shareholders, commences: "In a derivative action brought by one or more shareholders or members to enforce a right of a **corporation** or of an unincorporated association," certain procedural formalities must be met.

53 HB 13-1138 as initially approved by the House (Feb. 19, 2013), Section 1, proposed § 7-101-510(2).

54 HB 13-1138 as initially approved by the House (Feb. 19, 2013), Section 1, proposed § 7-101-510(2)(a).

55 HB 13-1138 as initially approved by the House (Feb. 19, 2013), Section 1, proposed § 7-101-510(3).

56 B Lab model act, § 301(c) with respect to directors of a **benefit corporation**, § 303(c) with respect to the **benefit** officer, and § 305(a)(2) with respect to the **benefit corporation**.

57 CRS § 7-101-510(4) with respect to the PBC and § 510(5) with respect to the directors and officers of the PBC. The language used was as follows:
(4) a **benefit corporation** is not liable for monetary damages for any failure of the **benefit corporation** to pursue or create general **public benefit** or a specific **public benefit**.
(5) a director or officer is not liable for monetary damages for:
(a) violation of any duty or standard of conduct under this part 5, if the director or officer performed the duties of office in compliance with section 7-108-401; or
(b) any failure of the **benefit corporation** to pursue or create general **public benefit** or a specific **public benefit**.

58 CRS §7-101-506(3).

59 CRS §7-101-503(1).

60 Codified in **Colorado** in CRS § 7-108-401(1).

61 Admittedly, the "marketing" rubric can be quite broad and, in fact, simply referring to the entity as a "**public benefit corporation**" or a "**benefit corporation**" may have a positive impact. Advertising the socially beneficial expenditures also may have a positive marketing impact.

62 Taylor, "Further Developments on the **Benefit Corporation** Front (Part 2)" (April 16, 2013), available at www.theracetothebottom.org/home/further-developments-on-the-**benefit**-**corporation**-front-part-2.html.

63 *Unocal Corp. v. Mesa Petroleum Co.,* 493 A.2d 946, 955 (Del. 1985). In a different context, which Professor Stephen Bainbridge refers to as "*"Revlon*-land" after *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.,* 506 A.2d 173, 182 (Del. 1986), "directors may not consider any interest other than shareholder wealth maximization." Bainbridge, "The Geography of *Revlon*-Land," 81 *Fordbam L. Rev.* 3277, 3315 (2013), available at ssrn.com/abstract=2115769.

64 The only case that has addressed this issue has done so in a different context. In *Newland v. Sebelius,* Case 1:12-cv-01123-JLK Document 30, (D.Colo. filed July 27, 2012), plaintiffs brought a suit against Kathleen Sebelius in her official capacity as U.S. Secretary of the Department of Health and Human Services (and other defendants) seeking an injunction to prevent the application of portions of the Patient Protection and Affordable Care Act (ACA), Pub. L. No. 111-148, 124 Stat. 119 (2010) to their business, Hercules Industries, Inc. In anticipation of the litigation, Hercules had amended its articles of incorporation to reflect attention to the principles of the Roman Catholic religion that were contrary to the application of the contraception mandate contained in the ACA. In granting the preliminary injunction, the Honorable John Kane implicitly confirmed the effectiveness of such amendment when he stated [citations to the amended complaint omitted]:
Although Hercules is a for-profit, secular employer, the Newlands adhere to the Catholic denomination of the Christian faith. According to the Newlands, "they seek to run Hercules in a manner that reflects their sincerely held religious beliefs." Thus, for the past year and a half the Newlands have implemented within Hercules a program designed to build their **corporate** culture based on Catholic principles. Hercules recently made two amendments to its articles of incorporation, which reflect the role of religion in its **corporate** governance: (1) it added a provision specifying that its primary purposes are to be achieved by "following appropriate religious, ethical or moral standards," and (2) it added a provision allowing members of its board of directors to prioritize those "religious, ethical or moral standards" at the expense of profitability.
This question has not been directly addressed.

65 B Lab model act (version of April 10, 2013), § 102, available at www.benefitcorp.net/storage/documents/Model_Benefit_Corporation_ Legislation.pdf.

66 It should be noted that the B Lab model act does not require that any benefit corporation identify specific benefit purposes; it merely requires that the benefit corporation pursue or create the potentially internally inconsistent "general public benefit."

67 CRS § 7-101-503(1)(a).

68 CRS § 7-101-506(1).

69 Callison, "Putting New Sheets on a Procrustean Bed: How Benefit Corporations Address Fiduciary Duties, the Dangers Created and Suggestions for Change," 2 *American University Business L. Rev.* 85, 86, 109 (2012), available at www.aublr.org.

70 CRS § 7-101-508; B Lab model act, § 305.

71 CRS§§ 11-51-101 *et seq.*

72 CRS §§ 6-16-101 *et seq.*

73 A "charitable organization" is defined as:
any person who is or holds himself out to be established for any benevolent, educational, philanthropic, humane, scientific, patriotic, social welfare or advocacy, public health, environmental conservation, civic, or other eleemosynary purpose, any person who operates for the benefit of the objectives of law enforcement officers, firefighters, other persons who protect the public safety, or veterans, or any person who in any manner employs a charitable appeal or an appeal which suggests that there is a charitable purpose as the basis for any solicitation.
CRS §6-16-103(1).

74 The term "solicit" is defined to mean directly or indirectly to request money or other things of value where any portion will be used for charitable purposes or for the benefit of any charitable organization. CRS § 6-16-103(10). "Charitable purposes"is defined to mean: any benevolent, educational, philanthropic, humane, scientific, patriotic, social welfare or advocacy, public health, environmental conservation, civic, or other eleemosynary purpose, any objective of law enforcement officers, firefighters, other persons who protect the public safety, or veterans, or any objective of sponsoring the free or subsidized attendance of persons at any event.
CRS § 6-16-103(2).

75 Notably, the Colorado Secretary of State contemplates compliance with the reporting obligations under the Charitable Solicitations Act by nonprofit corporations filing their annual IRS Form 990. *See* the Secretary of State's rules in the Code of Colorado Regulations at 8 CCR 1505-9 (entitled Rules for the Administration of the Colorado Charitable Solicitations Act). PBCs and LLCs that solicit donations for charitable purposes are not required by the IRS to file Form 990, but rather will be filing tax returns normally required of for-profit corporations. The Secretary of State's Office may have to engage in new rulemaking to accommodate the issues raised in the PBCA and in the Colorado LLC act.

76 CRS § 7-80-103. Compare this with the language authorizing nonprofit corporations in CRS § 7-123-101(1):
Every nonprofit corporation incorporated under articles 121 to 137 of this title [7] has the purpose of engaging in any lawful business or activity unless a more limited purpose is stated in its articles of incorporation.

77 A student note in the *William & Mary Business Law Review* concludes that the Internal Revenue Code should be interpreted so that "benefit expenses" (expenses for the identified benefit purposes) should be "viewed as ordinary and necessary to the trade or business of benefit corporations." Cohen, "Benefit Expenses: How the Benefit Corporation's Social Purpose Changes the Ordinary and Necessary," 4 *William & Mary Business L. Rev.* 269, 308 (2013), available at scholarship.law.wm.edu/wmblr/vol4/iss1/9.

78 29 USC §§ 1001 *et seq.*

79 ERISA, § 404(a)(1), 29 USC § 1104(a)(1) and the rules and regulations thereunder.

80 *See* "Legislation," available at www.bcorporation.net/what-are-b-corps/legislation.

81 "Triple bottom line," *The Economist* (Nov. 17, 2009), available at www.economist.com/node/14301663. The article goes on to state that the triple bottom line (TBL) "aims to measure the financial, social and environmental performance of the corporation over a period of time. Only a company that produces a TBL is taking account of the full cost involved in doing business."

82 Clark and Babson, "How Benefit Corporations Are Redefining the Purpose of Business Corporations," 38 *William Mitchell L. Rev.* 817, 819 (2012).

83 This is likely an exaggeration. Among the companies Sen. Heath mentioned were GoLite, LLC, an LLC (not a corporation) that can already accomplish anything a PBC can do under the Colorado Limited Liability Company Act, CRS §§ 7-80-101 *et seq.* Another company Sen. Heath mentioned was New Belgium Brewing, which is a private company understood to be owned entirely by an employee stock ownership plan. As discussed above, it likely would be difficult for an ERISA fiduciary to vote to give up a return on investment to the detriment of the ERISA plan beneficiaries.

84 Cline, the author of *Overdressed: The Shockingly High Cost of Cheap Fashion*, was interviewed on National Public Radio's "Fresh Air" on May 1, 2013. *See* www.npr.org/2013/05/02/180557959/ethical-fashion-is-the-tragedy-in-bangladesh-a-final-straw.

85 *See* "About the Institute," available at pierinstitute.org/about.htm.

86 See "Find a B Corp," available at www.bcorporation.net/community/find-a-b-corp?search=&=Search.

87 It is questionable even when there is an organization auditing labor standards or other "doing good" activities, whether they are accurate or complete, or whether a negative audit will result in any real change. In the NPR interview, host Terry Gross and author Cline had the following interchange regarding outside organizations that have inspected and rated the Bangladeshi and other garment factories:

GROSS: Shoppers who want to shop ethically can look at a store's social accountability rating. There's one rating given by Social Accountability International and one from the Fair Labor Association. Both of those were recently criticized by an AFL-CIO study called Responsibility Outsourced, and that study called the certification process for garment plans a façade, and said that the certifications keep wages low and working conditions poor, while providing public relations cover for the producers. How much have you investigated these accountability ratings?

CLINE: You can look at H&M's, their audits. I think they have them available online, if not, they're on the Fair Labor Association's website. And what's interesting is it's public knowledge, you can look through it and it'll be, like, this factor got a, you know, a C-rating or something, and they failed--or failed their audits for this reason and this reason and this reason, but we're going to implement these changes over the next couple of months.

See www.npr.org/templates/transcript/transcript.php?storyId =180557959, which includes the transcript of the entire thirty-eight minute interview.

88 As with most things, status as a PBC is not permanent, and with "the approval of the outstanding shares of each class of shares of the corporation of which there are outstanding shares, whether voting or nonvoting," the shareholders can terminate PBC status by amendment to the articles, conversion, or merger. CRS § 7-101-504(4). That results in the right to dissent from shareholders objecting to the change. CRS 7-113-102(1)(g), as added by the PBCA.

89 CRS §7-101-503(1).

90 In fact, it is arguable that long-term business sustainability balanced with short-term survivability is a material part of the existing business judgment rule (codified in Colorado at CRS § 7-108-401(1) and by statute and common law in many other states) in any event. Even before the Enron debacle when executives sold Nigerian barges to increase shortterm profits and their year-end bonuses (and failed to tell Arthur Andersen auditors about the repurchase obligation), the NYSE/NASD Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees published a report recommending greater involvement by audit committees of independent directors better balancing the interests of all stakeholders (54 *The Business Lawyer* 1057 (ABA, 1999)). Modern corporate governance is focused on creating sufficient incentives that corporate management take a longer term view. *See* McCahery *et al.*, "The Present and Future of Corporate Governance; Re-Examining the Role of the Board of Directors

and Investor Relations in Listed Companies," available at ssrn.com/abstract=2254520. The result of this is the requirement that NYSE-listed companies have a majority of independent directors *(NYSE Company Manual* (nysemanual.nyse.com), Rule 303A.01), that the non-management directors regularly schedule executive sessions without the management directors (Rule 303A.03), the nominating/**corporate** governance committee (Rule 303A.04), the compensation committee (Rule 303A.05), and the audit committee (Rule 303A.06) consist entirely of independent directors. Other exchanges have similar requirements and rules intended to encourage directors to focus on **longer**-term results. For a discussion of Enron's short-term thinking and the consequences thereof, *see* Ackman, "Enron's Nigeria Barge: The Real Deal," *Forbes Magazine* (Sep. 20, 2004), available at www.forbes.com/2004/09/20/cx_da_0920topnews.html and the numerous cases that fell out from the Enron collapse.

91 For a discussion of the dangers of short-term **corporate** thinking, *see* Malcolm, "Short-Termism at its Worst: How Short-Termism Invites Corruption ... and What to Do About It," www.ssrn.com/abstract=2247545. Among other things, Professor Salter argues that "short-termism" invites gaming and other forms of institutional corruption.

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WHITE PAPER

THE NEED AND RATIONALE FOR THE BENEFIT CORPORATION:

WHY IT IS THE LEGAL FORM THAT BEST ADDRESSES THE NEEDS OF SOCIAL ENTREPRENEURS, INVESTORS, AND, ULTIMATELY, THE PUBLIC

Principal Authors: William H. Clark, Jr., Drinker Biddle & Reath LLP; Larry Vranka, Canonchet Group LLC

Contributing Authors: Joshua Berick, Linklaters LLP; H. Kenneth Merritt, Jr., Merritt & Merritt & Moulton; John Montgomery, Montgomery & Hansen; Peter W. Sheehan Jr., Whiteford Taylor Preston; Sabrena Silver, Linklaters LLP; Donald S. Simon, Wendel Rosen Black & Dean; Jonathan S. Storper, Hanson & Bridgett

Drafting Authors: Elizabeth K. Babson, Drinker Biddle & Reath LLP; Matthew J. Brinker, Drinker Biddle & Reath LLP; David M. Carboni, Drinker Biddle & Reath LLP; Elizabeth Hang, University of Virginia School of Law, Class of 2011; Steven J. Haymore, Vanderbilt Law School, Class of 2011; Dennis P. O'Reilly, Drinker Biddle & Reath LLP; Dirk R. Sampselle, JD/MBA Candidate, Pepperdine University, 2013

Reviewers and Supporters: Allen Bromberger, Perlman & Perlman, LLP; Laura Jordan, The Capital Law Firm, PLLC; Jenny Kassan, Katovich & Kassan Law Group; John Katovich, Katovich & Kassan Law Group; Peter Roth, Varnum Attorneys at Law; Kyle Westaway, Westaway Law; Robert I. Wexler, Greenberg & Traurig LLP; Jeff D. Woodward, Stites & Harbison PLLC

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Executive Summary

There is significant interest in state legislatures and bar associations across the United States regarding legislation to introduce a new type of corporate legal entity – the benefit corporation. Legislation establishing the benefit corporation as a new type of corporate entity has already been passed and signed into law in California, Hawaii, Illinois, Louisiana, Massachusetts, Maryland, New Jersey, New York, Pennsylvania, South Carolina, Vermont, and Virginia, and has been introduced in several other states.

The sustainable business movement, impact investing and social enterprise sectors are developing rapidly but are constrained by an outdated legal framework that is not equipped to accommodate for-profit entities whose social benefit purpose is central to their existence. The benefit corporation is the most comprehensive yet flexible legal entity devised to address the needs of entrepreneurs and investors and, ultimately, the general public. Benefit corporations offer clear market differentiation, broad legal protection to directors and officers, expanded shareholder rights, and greater access to capital than current alternative approaches. As a result, the benefit corporation is also attracting broad support from entrepreneurs, investors, legal experts, citizens, and policy makers interested in new corporate form legislation.

The major characteristics of the benefit corporation form are: 1) a requirement that a benefit corporation must have a corporate purpose to create a material positive impact on society and the environment; 2) an expansion of the duties of directors to require consideration of non-financial stakeholders as well as the financial interests of shareholders; and 3) an obligation to report on its overall social and environmental performance using a comprehensive, credible, independent and transparent third-party standard. The enacting state's benefit corporation statutes are placed within existing state corporation codes so that the enacting state's existing corporation code applies to benefit corporations in every respect except those explicit provisions unique in the benefit corporation form.

The purpose of this white paper is to set out the need and rationale for this legislative initiative. The paper includes a brief discussion of demand in the market by business leaders and investors, an analysis of why current legal frameworks do not accommodate the activities of mission-driven private sector entities, a discussion of the benefit corporation form, why the model legislation is drafted the way it is and why it is the legal form that best addresses the needs of social entrepreneurs, investors and, ultimately, the public.

I. Market Demand by Consumers, Investors and Social Entrepreneurs

For-profit social entrepreneurship, social investing and the sustainable business movement have reached critical mass and are now at an inflection point. Accelerating consumer and investor demand has resulted in the formation of a substantial marketplace for companies that put purpose, not profit, at the center of the business.

(A) Consumers

A significant and growing population of consumers already aligns their purchases with their values, and many more have become conscious of the issue. Approximately 68 million U.S. consumers have stated a preference for making purchasing decisions based upon their sense of social and environmental responsibility.[1] Some consumers use their purchasing power to punish companies for negative corporate behavior,[2] and many other consumers use their purchasing power to reward companies that positively address a social or environmental issue. For example, surveys have shown that 49% of Americans would boycott companies whose behavior they perceive is not in the best interest of society.[3] Meanwhile, recent research has also indicated that where price and quality are equal, 86% of consumers would switch from their current brand to a brand that is socially responsible.[4] These consumer behaviors apply not just to purchases related to popular consumer products but also many other industries including telecommunications, banking, and professional services (e.g. law firms).[5]

As consumer demand for socially responsible products and companies is increasing, consumer trust in corporations is decreasing. Marketers use the terms "green," "responsible," "sustainable," "charitable," and words like them on a daily basis to describe their products or their companies. However, the more these terms are used, the less meaning they have because there are no standards to back up the claims.[6] This problem, often referred to as "greenwashing,"

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[1]Natural Marketing Institute ecoefficiency , *Benefits of Becoming a Sustainable Business,* Natural Marketing Institute (2008), *available at* http://www.eco-officiency.com/benefits_becoming_sustainable_business.html.

[2] *See*, *e.g.*, Lawrence Glickman, *Buying Power: A History of Consumer Activism in America* (University of Chicago Press 2009); Steven Levingston, *Whole Foods Boycott: the Long View* (September 2, 2009), *available at* http://voices.washingtonpost.com/shortstack/2009/09/whole_foods_boycott_the_long_v.html?hpid=news-col-blog.

[3] The McKinsey Quarterly, Shiela Bonini, Kerrin McKillop & Lenny Mendonca, *The trust gap between consumers and corporations*, 10 (2007).

[4] Cone Communications, *Cone Cause Evolution & Environment Survey*, Cone Research Report, 8 (2007), *available at* http://www.coneinc.com/files/2007ConeSurveyReport.pdf.

[5] Cone Communications, *2010 Cone Cause Evolution Study*, Cone Research Report, 10 (2010), *available at* http://www.coneinc.com/files/2010-Cone-Cause-Evolution-Study.pdf.

[6] For example, Exxon Mobile was named "Green Company of the Year" by Forbes Magazine in 2009 for its focus on natural gas (as opposed to coal). Christopher Hellman, *ExxonMobile: Green Company of the Year*, Forbes Magazine (August 24, 2009), *available at* http://www.forbes.com/forbes/2009/0824/energy-oil-exxonmobil-green-company-of-year.html. However, the Forbes article failed to assess its performance on other environmental issues, such as its lobbying against climate change or even the negative effects of natural gas on the environment. *See* Josh Harkinson, *Exxon Mobile: "Green Company of the Year?"* Mother Jones (August 27, 2009), *available at* http://motherjones.com/blue-marble/2009/08/exxonmobil-green-company-year-0. In the UK, Exxon advertisements claiming to be "eco-friendly" for its natural gas projects was banned as misleading in 2008.

is misleading for consumers and frustrating for businesses that try to distinguish themselves based on their social and environmental business practices. Consumers are less likely to trust a company's claims versus consumer reports or third party certifications.[7] As a result, various certifications, such as "Organic", "Fair Trade," "Energy Star", "Green Seal", "LEED" and "Forest Stewardship Council" have emerged to provide insight on particular aspects of a company's social or environmental performance.[8] Although there has been a proliferation of narrow product or practice specific standards like those mentioned, there are fewer standards that provide a comprehensive understanding of a company's performance as a whole. The lack of comprehensive and transparent standards is making it difficult for a consumer to tell the difference between a "good company" and just good marketing.

The general public preference for supporting "good companies" is not limited to purchases. People also prefer to work for companies who are committed to social and environmental issues. More than two-thirds of employees (69%) consider the social and environmental track record of a company in deciding where to work.[9] This preference is especially strong among MBA graduates, who overwhelmingly (88%) have said that they would be comfortable taking a pay cut to work for a company that has ethical businesses practices versus one that does not.[10]

(B) Investors

The socially responsible investing (SRI) movement has grown over the past 30 years to represent nearly 10% of U.S. assets under management, or roughly $2.3 trillion.[11] SRI has evolved in both the public and private markets, becoming an institutionalized sector of the professional asset management market and giving rise to a distinct venture capital and private equity industry of funds and individual investors seeking values-aligned investment opportunities.

Some SRI investors use screens to avoid "sin" (e.g., tobacco, alcohol, gaming) and weapons stocks or to reward social or environmental "best in class" companies in each industry sector in their portfolio; others engage with corporations to change their behaviors through shareholder resolutions or other forms of activism; while others, increasingly being called impact investors, seek to create more direct social impact through targeted direct equity and debt investments in businesses such as community banks, microfinance institutions, clean-tech or

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[7] BBMG, *Conscious Consumers Report: Redefining Value in a New Economy*, 16 (2009), *available at* http://bbmg.com/.
[8] For a description of these and other symbols, *see Guide to Green Symbols*, *available at* http://www.easywaystogogreen.com/green-guides/guide-to-green-symbols/ (last visited September 9, 2011).
[9] *2010 Cone Cause Evolution Study*, 8 (2010).
[10] Harvard Business Review, *New MBAs Would Sacrifice Pay for Ethics,* The Daily Stat (May 17, 2011), *available at* http://web.hbr.org/email/archive/dailystat.php?date=051711. The average pay cut the MBA students would accept to work for a responsible business is about $8,000 per annum. *Id*.
[11] US SIF: The Forum for Sustainable and Responsible Investment, *2010 Report on Socially Responsible Investing* (2010), *available at* http://ussif.org/. *See also* US SIF Website, *Socially Responsible Investing Facts* (visited on September 9, 2011), *available at* http://ussif.org/resources/sriguide/srifacts.cfm.

green businesses or social venture funds investing globally across developed and emerging markets.[12]

A November 2010 report by J.P. Morgan, entitled "Impact Investments: An emerging asset class," estimates the size of this market opportunity at between $400 billion and $1 trillion.[13] This only included investment opportunities in emerging markets across five sectors: housing, rural water delivery, maternal health, primary education, and financial services. J.P. Morgan estimates the 10-year profit potential from these opportunities alone ranged between $183 billion and $667 billion.[14] Approaching it from the demand side of the equation, and focused only on U.S. individual investors, a June 2010 "Money for Good" report from Hope Consulting estimates a demand for impact investments among U.S. high net worth individuals at $120 billion.[15]

Like consumers, investors lack the comprehensive tools to understand the complete picture of a company's performance across the full range of social and environmental measures. Likewise, businesses may have a hard time attracting investors by distinguishing themselves among the sea of companies that claim to be "socially responsible." Furthermore, the current trend, particularly in the public capital markets and among policy makers and large public corporations serious about sustainability, is to encourage integrated sustainability reporting using credible third party standards. According to Institutional Shareholder Services (ISS), the largest shareholder proxy advisory organization in the world, this trend is also true for institutional investors who "appear to be increasingly incorporating social and environmental considerations into their proxy voting decisions, as demonstrated by voting trends and institutional investor initiatives."[16]

(C) Entrepreneurs

For-profit social entrepreneurs have gained increasing prominence on the business landscape. Probably the highest profile example of this has been the awarding of the Nobel Peace Prize to Muhammad Yunus for his pioneering work in microfinance, but there are many other examples.[17] Although there is no reliable data on "social enterprise" company revenues, an

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[12] *See Socially Responsible Investing Facts*, *supra* note 11 (highlighting screening, shareholder advocacy and community investing as typical investor approaches).
[13] J.P. Morgan Global Research, *Impact Investments: An Emerging Asset Class* (Nov. 29, 2010), *available at* http://www.jpmorgan.com/pages/jpmorgan/investbk/research/impactinvestments. *See also* Nicholas Timmons, *Impact Investment "a burgeoning asset class,"* Financial Times (Nov. 28, 2010), *available at* http://www.ft.com/intl/cms/s/0/e875dda6-fae6-11df-b576-00144feab49a.html?ftcamp=rss#axzz1XUogcz2a (summarizing the J.P. Morgan report).
[14] Id.
[15] Hope Consulting, Strategies for Social Change, *Money for Good Report* (2010)., http://www.hopeconsulting.us/money-for-good.
[16] Carolyn Mathiasen & Erik Mell, Institutional Shareholder Serv., *Corporate Social Issues: A 2011 Proxy Season Preview: United States* 1 (2011).
[17] Muhammad Yunus is known as a "banker for the poor" and won the Nobel Prize in 2006 for his work with the Grameen Bank in Bangladesh. For a biography of Muhammad Yunus and information regarding his work *see* Nobelprize.org, Nobel Peace Prize 2006, *available at* http://www.nobelprize.org/nobel_prizes/peace/laureates/2006/yunus-bio.html.

aggregation of businesses belonging to membership associations generally identified with the sustainable business movement reveals a marketplace of over 65,000 businesses with over $40 billion in revenues.[18]

The pipeline of future for-profit social entrepreneurs is filling rapidly as most top business schools offer a program in Social Entrepreneurship.[19] The membership of Net Impact, a network of business school students and young professionals using business as a tool for social change, is over 10,000 in 125 chapters globally. There are numerous additional companies that do not self-identify as "socially responsible" but nevertheless behave that way, and there are other sectors of the economy such as health care, education, housing, food, agriculture and consumer products with concentrations of high-impact businesses.

The current marketplace, however, continues to be fragmented and confusing. As noted above, entrepreneurs that are "sustainable," "green" or "socially responsible," may find that it is hard to distinguish themselves from other companies that make similar claims but don't actually behave as they advertise. Furthermore, the current legal framework is structured to ensure profit maximization, not social responsibility.[20] Because of this, entrepreneurs with a mission-driven business may be reluctant to accept outside capital from investors who may not share their long term vision for social and environmental responsibility.

(D) Certified B Corporations

In 2007, in response to this fragmentation and confusion, B Lab, a 501(c)(3) not-for-profit organization, initiated a certification system for companies interested in distinguishing themselves in this cluttered marketplace. B Lab developed a set of transparent, comprehensive and comparable standards designed to enable the marketplace to identify and support companies that meet rigorous third-party standards for social and environmental performance.

An important issue these certification standards address is the legal issue arising out of the tension between a corporation pursuing a social mission, on the one hand, and the more conventional corporate mandate of maximizing shareholder value, on the other, by requiring companies to consider stakeholders[21] other than shareholders when making corporate decisions.

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[18] A partial listing of these associations includes: Green America, Social Venture Network, Investors Circle, Business Alliance for Local Living Economies, Transfair USA, Social Investment Forum, National Cooperative Business Association and the National Center for Employee Ownership.

[19] For example, Duke University's Fuqua School of Business has the Center for the Advancement of Social Entrepreneurship, University of Pennsylvania's Wharton School of Business has several social entrepreneurship programs, including the Social Enterprise Fellowship Program, and Northwestern University's Kellogg School of Management provides the Carol and Larry Levy Social Entrepreneurship Lab.

[20] For a discussion of the objective and conduct of a corporation generally, *see*, *e.g.*, 1 Principles of Corporate Governance, § 2.01 (Am. Law Inst., May 13, 1992) (noting that a business corporation should have as its objective the conduct of such activities with a view to enhancing corporate profit and shareholder gain, but that its pursuit of the economic objective must be constrained by social imperatives and *may* be qualified by social needs).

[21] The term "stakeholder" is commonly used to refer to a person, group, or organization that has a direct or indirect stake in an organization because it can affect or be affected by the organization's actions, objectives and policies. Key stakeholders in a business organization include customers, directors, employees, shareholders, suppliers, the

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For-profit companies pursuing a social mission face increasing difficulty as they scale; as officers and directors of these entities consider investments, mergers or liquidity events, the default position tends to favor the traditional fiduciary responsibility to maximize returns to shareholders over the company's social mission. Many leaders of early and growth-stage mission-driven businesses fear being pressured to change business practices or pursue strategic alternatives to independent growth by investors whose financial interests often diverge over time from the social mission of the company. Whatever the letter of the law, these fears, combined with both prevailing business culture and advice of counsel about the risk of litigation if one fails to maximize shareholder value, have a chilling effect on corporate behavior as it relates to pursuit of a social mission. These fears are exacerbated by cautionary tales of investor-led board takeovers of private companies and stories like the iconic forced sale of Ben & Jerry's to Unilever.

As a result of these perceived legal and marketing needs of mission-driven businesses, more than 460 companies from more than 60 different industries have become Certified B Corporations over the last four years, indicating a strong desire among leaders within the sustainable business movement to adopt a legal framework with this higher standard of consideration of stakeholder interests.

Although the B Corporation certification process requires a company to implement certain "fixes" to its articles of incorporation and other organizational documents, these "fixes" can be difficult because they must be made within the context of existing legal frameworks (discussed in greater detail in Section III below).

The legal framework currently used by companies to earn certification as a B Corporation is generally seen as not being available to companies incorporated in any of the nineteen states that do not have a statute that explicitly allows directors to consider the interests of constituencies other than shareholders (called a "constituency statute"). Even in states with constituency statutes, the creation of a new corporate entity provides additional legal clarity that the fiduciary duty of directors of a benefit corporation includes consideration of stakeholder interests and that shareholders have the right to enforce that standard of consideration.

In addition to addressing these legal limitations, legal recognition of a new corporate entity creates legitimacy for and accelerates growth of this emerging marketplace by making it easier for the next generation of entrepreneurs and investors to build businesses that seek to create value for both shareholders and society. The new benefit corporation form facilitates greater recognition of these businesses by consumers, investors and policy makers by establishing a higher bar of corporate governance without requiring certification by a third party for a fee and without prescribing specific corporate activities.

All of these factors call for the creation of a legal framework for a new class of corporations that are designed to create benefit for all stakeholders, not just shareholders.

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community from which the business draws its resources, etc. *See* definition of stakeholder, BusinessDictionary.com (last visited September 27, 2011).

II. Existing Legal Frameworks Do Not Accommodate For-Profit Mission-Driven Companies

Historically, the U.S. legal system governing corporate entities and their activities has not been structured or tailored to address the situation of for-profit companies who seek to use the power of business to solve social problems. This white paper will not detail all of the legal distinctions between for-profit and not-for-profit entities but, broadly speaking, at the federal level the system is structured as a binary one, dividing business organizations into either for-profit or not-for-profit, with U.S. federal tax law guarding the divide between these sectors and their mandated and permissible activities.[22]

Social entrepreneurs have recognized the limitations of the not-for-profit form and the potential power of business and are increasingly deciding to organize and operate as for-profit entities. This decision gives rise to a complex set of legal issues at the state level, which in turn leads to uncertainty and impairs the growth of these types of entities and this new sector of the economy.

(A) Background

The notion that a business corporation has as its purpose creating financial gain for its shareholders was forcefully articulated by the Michigan Supreme Court almost 100 years ago in the following statement in *Dodge v. Ford*:[23]

"A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself, to the reduction of profits, or to the non-distribution of profits among stockholders in order to devote them to other purposes."

Dodge v. Ford does not stand alone, and cases in other jurisdictions have reiterated the shareholder maximization duty that "[i]t is the obligation of directors to attempt, within the law, to maximize the long-run interests of the corporation's stockholders."[24] Though still a staple in many law school casebooks, a strict reading of *Dodge v. Ford* and other cases that specify shareholder wealth maximization as a fiduciary duty has been criticized by those who believe that these cases do not represent the current state of modern corporate law.[25] Nevertheless,

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[22] Generally, not-for-profit entities are afforded certain tax benefits (including tax-exempt status and deductibility of contributions by financial supporters) so long as they pursue a clearly-defined charitable purpose and comply with other requirements. Among other things, federal tax law (i) precludes not-for-profit entities from distributing any profits, thus making it difficult for nonprofits to attract capital; (ii) limits financial remuneration of employees, thus making it difficult for nonprofits to attract and retain talent; and (iii) limits the revenue-generating activities of such entities which would in the private sector ordinarily accompany sustainably operating and expanding like a successful business. For a further discussion of nonprofits see the discussion in Appendix C.

[23] 204 Mich. 459, 507, 170 N.W. 668, 684 (1919).

[24] *Katz v. Oak Indus., Inc.* 508 A.2d 873, 879 (Del. Ch. 1986). *See also Long v. Norwood Hills Corp.*, 380 S.W.2d 451 (Mo. Ct. App. 1964); *Granada Invs., Inc. v. DWG Corp.*, 823 F. Supp. 448, 459 (N.D. Ohio 1993).

[25] Some commentators have suggested that the decision in *Dodge v. Ford* to award the shareholders a special dividend was not based on shareholder wealth maximization principles, but rather a breach of duty of good faith to

(Continued)

Dodge v. Ford remains good law and many still maintain that its "theory of shareholder wealth maximization has been widely accepted by courts over an extended period of time."[26] It is against the paradigm of shareholder primacy that directors and their advisors analyze corporate decision making.

(B) Fiduciary Duties

In the United States, corporations and other types of business entities are constituted under state law, and their directors and managers are subject to standards of conduct imposed by state law (both statutes as well as judicial interpretations thereof). Generally, these laws require the directors, who are elected by the shareholders, to manage or direct the management of the corporation's business and affairs. The directors may (and typically do) delegate some of their authority to the corporation's officers, insofar as the day-to-day activities of the corporation are concerned.

In discharging their statutory obligations, directors owe certain duties–referred to as fiduciary duties–to the corporation itself and to the corporation's shareholders. Corporate law has long recognized two basic fiduciary duties for corporate directors: a duty of loyalty and a duty of care. Under the duty of loyalty, directors are required to pursue the best interests of the corporation and to place those interests above their own whenever those interests conflict. Under the duty of care, directors must exercise good business judgment and use ordinary care and prudence in the operation of the business.

Although corporate law is state-specific, the general concept of fiduciary duties is fairly standard across jurisdictions. "Constituency" statutes, discussed in greater detail below, are one of the main statutory differentiators from state to state with respect to fiduciary duties. Constituency statutes, which were developed mainly by state legislatures as a defensive mechanism for local companies that are subject to a hostile takeover, give the target company's board the discretion to favor a deal that is better for the company's employees, the community and the local economy over a deal with a higher purchase price but more detrimental effects to the community. If there is no competing deal, the constituency statute permits a board to examine the potential transaction's impact on the community and reject it on that basis.

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minority shareholders by withholding special dividends to freeze them out. Judd F. Sneirson, *Green is Good: Sustainability, Profitability, and a New Paradigm for Corporate Governance*, 94 Iowa L. Rev. 987, 1001-1003 (2009) (noting that *Dodge v. Ford* has only been cited by Delaware three times, twice as authority for the close corporation issue, and arguing that it should not be taught as a case of precedential value with respect to a duty of shareholder maximization). Sneirson describes three other cases that clearly identify a duty of shareholder maximization of value, but dismisses the precedential value of these cases on that point and notes that they are rarely cited for that proposition. *Id*. at 1004. *But see* Jonathan R. Macey, *A Close Read of an Excellent Commentary on Dodge v. Ford*, 3 Va. L. & Bus. Rev. 177, 179 (2008) (stating that the shareholder maximization ideal in *Dodge v. Ford* actually drives the holding and is not mere dicta); Stephen M. Bainbridge, *Corporation Law and Economics* §§ 1.4(b), 9.2, and 9.3 (2002).

[26] Stephen M. Bainbridge, *Corporation Law and Economics* §§ 1.4(b), 9.2, and 9.3 (accepting the theory of shareholder maximization expressed in *Dodge v. Ford*). *See also* Macey, *supra* note 25, 3 Va. L. & Bus. Rev. at 179 (stating that the shareholder maximization ideal in *Dodge v. Ford* is widely accepted as a matter of rhetoric).

With the increase of mission-driven and "triple bottom line corporations,"[27] these constituency statutes are now being analyzed outside the context of a hostile takeover. For these businesses, the answer to a key question–whether a company's directors may consider non-financial interests when making a decision as to the "the best interest of the corporation"–depends to a significant extent on the laws of the state where the company is incorporated. In this regard the states can be divided into two categories: "constituency" states and "non-constituency" states.

1. Constituency States

The directors of companies incorporated in constituency states are expressly permitted by statute to consider persons other than shareholders in the discharge of their fiduciary duties. Constituency statutes generally provide that, in fulfilling their fiduciary duties, directors may consider the effects of a decision not only on shareholders, but also on a list of other "constituency" groups.[28] These permissible constituency groups vary state by state, but usually include employees, creditors, suppliers, consumers and the community at large.[29] Thirty-three states now have some version of a constituency statute.[30] Conspicuously absent from the list of

[27] The phrase "the triple bottom line" was first coined in 1994 by John Elkington, the founder of a British consultancy called SustainAbility. *See* The Economist, *Triple Bottom Line: It consists of Three Ps: Profit, Planet and People*, http://www.economist.com/node/14301663 (November 17, 2009). Elkington argued that businesses should considers three "bottom lines" of people, planet and profit rather than the traditional formula of pure profit as the bottom line of a business. *Id*. Today, this term, like "mission driven," "sustainable," and other similar terms, is commonly used among social entrepreneurs and investors to refer to businesses that consider other interests in additions to profits and shareholder value maximization.

[28] As noted above, many constituency provisions in state corporate statutes were enacted in response to takeover activity in the 1980s as a way to protect local businesses. Eric W. Orts, *Beyond Shareholders: Interpreting Corporate Constituency Statutes*, 61 GEO. WASH. L. REV. 14, 23-26 (1992). It is worth noting that these constituency statutes are permissive rather than mandatory, i.e., they provide that the directors may consider the interests of stakeholders other than shareholders but are not required to. *See id*. at 26-31 (discussing varieties of state constituency statutes).

[29] *See, e.g.*, 805 ILL. COMP. STAT. § 5/8.85 (2004) (stating directors "may . . . consider the effects of any action . . . upon employees, suppliers and customers of the corporation or its subsidiaries, communities in which offices or other establishments of the corporation or its subsidiaries are located, and all other pertinent factors"); N.Y. BUS. CORP. LAW § 717(b)(2)(i)-(v) (McKinney 2003) (stating directors "shall be entitled to consider . . . the effects that the corporation's actions may have in the short-term or in the long-term upon any of the following: (i) the prospects for potential growth, development, productivity and profitability of the corporation; (ii) the corporation's current employees; (iii) the corporation's retired employees and other beneficiaries receiving or entitled to receive retirement, welfare or similar benefits from or pursuant to any plan sponsored, or agreement entered into, by the corporation; (iv) the corporation's customers and creditors; and (v) the ability of the corporation to provide, as a going concern, goods, services, employment opportunities and employment benefits and otherwise to contribute to the communities in which it does business"); 15 PA. CONS. STAT. § 1715(a)(1) (West 1995) (stating directors may consider "[t]he effects of any action upon any or all groups affected by such action, including shareholders, employees, suppliers, customers and creditors of the corporation, and upon communities in which offices or other establishments of the corporation are located").

[30] *See* ARIZ. REV. STAT. ANN. § 10-2702 (2004); CONN. GEN. STAT. § 33-756(D) (2007); FLA. STAT. § 607.0830(3) (2008); GA. CODE ANN. § 14-2-202(B)(5) (2003); HAW. REV. STAT. § 414-221(A)-(B) (2008); IDAHO CODE ANN. § 30-1602 (2010); 805 ILL. COMP. STAT. 5/8.85 (2004); IND. CODE § 23-1-35-1(D) (1999); IOWA CODE § 490.1108A (1999); KY. REV. STAT. ANN. § 271B.12-210(4) (LEXISNEXIS 2006); LA. REV. STAT. ANN. § 12:92(G) (1994); ME. REV. STAT. ANN. TIT. 13-C, § 832 (2005); MD. CODE ANN., CORPS. & ASS'NS § 2-104(B)(9) (West 2008); MASS. GEN. LAWS CH. 156B, § 65 (2006); MINN. STAT. § 302A.251(5) (2008); MISS. CODE ANN. § 79-4-8.30 (2001); MO.

(Continued)

states adopting constituency statutes is Delaware, where more than 900,000 business entities have their legal home, including more than 50% of all U.S. publicly-traded companies and 63% of the Fortune 500.[31] Most states, including those with constituency statutes, will at a minimum consider Delaware law when interpreting local corporate law.

While it is clear that directors of mission-driven companies incorporated in constituency statute jurisdictions may take into consideration the interests of various constituencies when exercising their business judgment, the lack of case law interpreting constituency statutes, coupled with the context in which many of these statutes were enacted, makes it difficult for directors to know exactly how, when and to what extent they can consider those interests. For example, neither the constituency statutes themselves nor state case law address questions such as how directors should decide which parties fall within a protected constituency category, what weight the directors should assign to shareholder and non-shareholder interests and what standards a court should use in reviewing directors' decisions to consider (or not to consider) non-shareholder interests. Based on the limited case law available, courts seem reluctant to wade into these issues and often fall back on shareholder primacy.[32]

Without clear authority explicitly permitting directors to pursue both profit and a company's mission, even directors of mission-driven companies in constituency statute jurisdictions may be hesitant to "consider" their social missions for fear of breaching their fiduciary duty.[33] This uncertainty and resulting hesitation makes it difficult for the directors of mission-driven companies to feel they are legally protected in considering the interests of constituencies other than the shareholders who have elected them (and can therefore replace them).

Further, permissive constituency statutes only create the option (and not the requirement) for directors to consider interests of constituencies other than shareholders. Thus, directors have the permission not to consider interests other than shareholder maximization of value. Mission-driven executives and investors are often in minority shareholder positions and would prefer that directors and officers be required to consider these expanded interests when making decisions,

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REV. STAT. § 351.347(1) (2000); NEB. REV. STAT. § 21-2432(2) (2007); NEV. REV. STAT. ANN. § 78.138(4) (2007); N.J. STAT. ANN. § 14A:6-1(2) (West 2003); N.M. STAT. ANN. § 53-11-35(D) (West 2003); N.Y. BUS. CORP. LAW § 717(B) (MCKINNEY 2003); N.D. CENT. CODE § 10-19.1-50(6) (2005); OHIO REV. CODE ANN. §§ 1701.59(E) (LEXISNEXIS 2004); OR. REV. STAT. § 60.357 (2007); 15 PA. CONS. STAT. § 1715(A)(1) (West 1995); R.I. GEN. LAWS § 7-5.2-8 (1999); S.D. CODIFIED LAWS § 47-33-4 (2002); TENN. CODE ANN. § 48-103-204 (West 2008); VT. STAT. ANN. TIT. 11A, § 8.30 (2008); VA. CODE ANN. § 13.1-727.1 (2006); WIS. STAT. § 180.0827 (2006); WYO. STAT. ANN. § 17-16-830(E) (2007).

[31] Division of Corporations Website, http://corp.delaware.gov/ (visited on August 22, 2011).

[32] *See, e.g.*, *Baron v. Strawbridge & Clothier*, 646 F. Supp. 690, 697 (E.D. Pa. 1986) (stating that, while it was proper for directors facing takeover attempts to consider corporation's employees, customers and community, their fiduciary duty was still "to act in the best interests of the corporation's shareholders"). Also, it is either expressly provided or generally understood that these non-shareholder constituencies do not have standing to sue on the basis that the directors failed to consider their interests, making it less likely that directors will be concerned about them.

[33] Directors who have invoked constituency statutes have usually done so when sued for breach of fiduciary duty in the course of defending against takeover attempts. Constituency statutes are just one of many potential defenses that directors may use, and directors have been more likely to rely on anti-takeover mechanisms that have been proven in court and that do not call into question the directors' fiduciary duties.

with a shareholder right of action providing the "teeth" to enforce such consideration. This is particularly true in situations where a company is considering strategic alternatives and directors' discretion in making business decisions is more limited by traditional principles requiring shareholder value maximization.[34]

2. Non-Constituency States

In non-constituency states, including Delaware, consideration of a public mission is even more problematic, because under the corporate laws of those states the directors are not expressly permitted to consider the interests of stakeholders or constituents other than shareholders in the discharge of their duties.[35]

As mentioned above, Delaware is the state under which a majority of U.S. public companies, and numerous private companies, particularly those with or interested in attracting outside capital, are incorporated, due in significant part to its well-developed body of corporate law, and Delaware does not have a constituency statute. In *eBay Domestic Holdings, Inc. v. Newmark*,[36] the Delaware Court of Chancery recently reaffirmed its position that corporate directors are obligated pursuant to their fiduciary duties to maximize shareholder value.[37] Chancellor Chandler also made clear that a public-service mission which "seeks not to maximize the economic value of a for-profit Delaware corporation for the benefit of its stockholders" is an invalid corporate purpose and inconsistent with directors' fiduciary duties.[38]

(C) Levels of Scrutiny of Director Decisions

It is important to note that, as a general matter, the level of scrutiny a court will give to the decisions of a director (in both constituency and non-constituency states) is dependent in part on the context in which the decision is being made. To use Delaware as an example again, its courts review director decision-making in three broad categories, or scenarios: (1) day-to-day decisions, (2) defensive decisions,[39] and (3) change of control decisions.[40]

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[34] *See, e.g.*, *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986) (stating that directors, faced with a hostile takeover bid for a corporation, may only consider various non-shareholder constituencies if "there are rationally related benefits accruing to the stockholders").

[35] *See, e.g.*, CA. CORP. CODE § 309(a) (West 2011) (stating that director must discharge his or her duties "in good faith, in a manner such director believes to be in the best interests of the corporation and its shareholders and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances"); MICH. COMP. LAWS § 450.1541a (2011) (stating similarly that director must discharge his or her duties "[i]n good faith . . . [w]ith the care an ordinarily prudent person in a like position would exercise under similar circumstances . . . [i]n a manner he or she reasonably believes to be in the best interests of the corporation"); N.C. GEN. STAT. § 55-8-30 (2011) (same).

[36] 16 A.3d 1 (Del. Ch. 2010) ("*eBay*").

[37] *Id.*, at 34.

[38] *Id.*; *see id.* at 33 (stating that "promoting, protecting or pursuing non-stockholder considerations [with defensive measures] must lead at some point to value for stockholders").

[39] Defensive decisions are those taken by directors in an effort to ward off potential bidders, whether friendly or hostile.

[40] Change of control decisions are those decisions taken by directors once it is clear that a company will be sold.

In the day-to-day context, directors can consider non-shareholder interests as long as they can show a rational connection between that consideration and shareholder value.[41] This is because courts review director decisions in the day-to-day context under the deferential "business judgment rule." The business judgment rule is a rebuttable presumption by courts that "in making a business decision the directors of a corporation act on an informed basis, in good faith, and in the honest belief that the action taken [is] in the best interest of the company."[42] In other words, courts reviewing decisions made in the day-to-day context will not question rational judgments about how seemingly promoting non-shareholder interests (such as a corporation's decision to make charitable contributions or to otherwise support the community in which their operations are located) ultimately promote shareholder value.[43]

Even in the day-to-day context in which directors enjoy most discretion, decisions must show some connection to shareholder value. While it is not true that all decisions that reflect consideration of non-shareholder interests lead to a reduction in shareholder value (and some in fact may lead to its increase), it is true that some might result in a diminishment of shareholder value, even over the long term. Moreover, some mission-driven business executives and investors may be comfortable with that result in the pursuit of their social mission, whether that mission is reflected in providing below-market pricing of health insurance to the otherwise uninsured, accepting higher cost of production from overseas factories audited by a third party for their social and environmental standards, or focusing on smaller, less profitable market segments that seek "better" products or need basic services. In these instances, the resolution of litigation by a shareholder seeking maximized financial return against the directors of such a mission-driven company, even under this level of scrutiny, would be uncertain at best from the perspective of the mission-driven company and its directors. This uncertainty can have a chilling effect on the pursuit of social missions.

When defending takeover attempts, directors generally enjoy significantly less deference regarding decisions (including consideration of non-shareholder interests) that on their face do not seem designed to maximize shareholder value. When directors act defensively, Delaware courts apply the standards set forth in *Unocal Corporation. v. Mesa Petroleum Company*.[44] Under *Unocal*, Delaware courts will give directors the benefit of the business judgment rule only if the directors can first demonstrate that they were responding to a legitimate threat to corporate policy and effectiveness and that their response was "reasonable in relation to the threat posed."[45] As previously mentioned, Chancellor Chandler found in eBay that a public-service mission was not a legitimate corporate policy, and thus taking defensive measures to protect that mission violates *Unocal*.[46] The court stated:

> "Directors of a for-profit Delaware corporation cannot deploy a [policy] to defend a business strategy that openly eschews stockholder wealth

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[41] *See Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984) (stating that director's decisions must be "on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the company").
[42] *Aronson*, 473 A.2d at 812.
[43] *eBay*, 16 A.3d at 33-34.
[44] 493 A.2d 946 (Del. 1985) ("*Unocal*").
[45] *Unocal*, 493 A.2d at 949.
[46] *eBay*, 16 A.3d at 32, 34.

maximization – at least not consistently with the directors' fiduciary duties under Delaware law."[47]

While the facts of *eBay* are unique and a different company's publicly-oriented mission may be considered a legitimate corporate policy, Chancellor Chandler's language suggests that Delaware courts will seek to limit the "purely philanthropic ends" of mission-driven companies, especially when their directors' decisions are reviewed under *Unocal's* scrutiny.

If defending takeover attempts severely restricts directors' ability to consider non-shareholder interests, a corporate sale effectively eradicates any such ability in a non-constituency state. A company goes "up for sale" when it initiates an active bidding process to sell itself or to reorganize itself in a way that will clearly break up the company, or when, in response to an active bidder's offer, the company abandons its long-term strategy and seeks an alternative transaction with a preferred party that will result in a change of control of the company.48 In these circumstances, Delaware and other state case law has made clear that the directors' only duty is to maximize shareholder value by securing the highest bid reasonably available and that "concern for non-stockholder interests is inappropriate when an auction among active bidders is in progress."[49] These duties—the duty to maximize shareholder value and the corollary obligation to disregard all other considerations—are referred to as 'Revlon duties,' and originate from the landmark case Revlon Inc. v. MacAndrews & Forbes Holding, Inc.50 While skilled legal counsel can give directors guidance on how to attempt to circumvent Revlon duties, there remains ambiguity about when Revlon duties are triggered. That ambiguity frequently leads to Revlon-based lawsuits.

There is a credible view among some academic legal experts that because there is no specific provision in the Delaware statute preventing consideration of other stakeholder interests, if a company were to actually include the requirement of such consideration, including the possibility of not maximizing shareholder value, in the purpose clause of its certificate of incorporation or in defining the directors' fiduciary standards, such a requirement might withstand the court's scrutiny in a defensive or change of control situation and be given effect. However, in addition to there being no underlying statute that permits such consideration, there is no case law to support this view. In the absence of statutory authority or precedent and in light of decisions including Revlon and eBay, the practical reality is that practitioners – general counsel and outside counsel – are typically unwilling to recommend such a course of action because the legal analysis is so unclear.

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[47] *Id*. at 35.

[48] *See Paramount Communications, Inc. v. Time, Inc.*, 571 A.2d 1140, 1150 (Del. 1989) (outlining two circumstances in which directors must consider maximizing shareholder value above any other consideration).

[49] *Revlon, Inc. v. MacAndrews & Forbes Holding, Inc.*, 506 A.2d 173, 182 (Del. 1986) ("*Revlon*"); *see also Plaza Sec. Co. v. Fruehauf Corp.*, 643 F. Supp. 1535, 1543 (E.D. Mich. 1986) (stating "[i]n a contest for corporate control, when directors have determined that it is inevitable that the corporation be sold, . . . the directors' cardinal fiduciary obligation to the corporation and its shareholders is to ensure 'maximization of the company's value at a sale for the stockholders' benefit.'" (citing *Revlon*, 506 A.2d at 182.)).

[50] *Revlon*, 506 A.2d 173 (Del. 1986).

(D) Impact of Legal Framework on Mission-Driven Companies

Based on the established state legal frameworks, directors face legal uncertainty in all of the aforementioned contexts. In the day-to-day context where the business judgment rule applies, a judge may not find it to be appropriate to consider and advance non-shareholder interests for their own sake (i.e., as part of the company's mission) and not as a way of maximizing long-term shareholder financial value; in a *Unocal* context a corporate mission or culture that is not based on maximizing shareholder value may not be seen as legitimate and capable of being the subject of a defensive measure; and in a *Revlon* context it would certainly be a breach of fiduciary duty based on existing case law in a non-constituency state (and since there is a dearth of case law on the subject, arguably in a constituency state as well) to consider non-shareholder interests if such consideration did not maximize shareholder value.

These legal uncertainties and the need for greater clarity have led to calls for new legal solutions that address the unique needs of for-profit mission-driven businesses. However, none of the alternatives to benefit corporations devised to date (namely, hybrid nonprofits, low-profit limited liability companies (L3Cs) and Flexible Purpose Corporations, each of which is discussed in Appendix C to this paper) meet the needs of the entrepreneurs, investors, and consumers described in Section II and all have significant technical and policy issues associated with their approach that make them relatively ineffective in serving the public interest.

III. Benefit Corporations

To date, California, Hawaii, Illinois, Louisiana, Massachusetts, Maryland, New Jersey, New York, Pennsylvania, South Carolina, Vermont, and Virginia have changed their corporate law to allow for a new entity called the "benefit corporation."[51] Six other states (Alabama, Arizona, Michigan, New Mexico, North Carolina, Oregon) and the District of Columbia, have

[51] *See* CAL. CORP. CODE § 14600 (Deering 2013) ("California Statute"); HAW. REV. STAT. § 420D-1 (2013) ("Hawaii Statute"); 805 ILL. COMP. STAT. 40/1 (2013) ("Illinois Statute"); LA. REV. STAT. ANN. § 12:1801 (2013) ("Louisiana Statute"); MASS. ANN. LAWS ch. 156E, § 1 (LexisNexis 2013) ("Massachusetts Statute"); MD. CODE ANN., CORPS. & ASS'NS § 5-6C-01 (LexisNexis 2013) ("Maryland Statute"); N.J. STAT. ANN. § 14A:18-1 (2013) ("New Jersey Statute"); N.Y. BUS. CORP. LAW § 1701 (Consol. 2013) ("New York Statute"); 15 PA. CONS. STAT. § 3301 (2013) ("Pennsylvania Statute"); S.C. CODE ANN. § 33-38-110 (2013) ("South Carolina Statute"); VT. STAT. ANN. tit. 11A, § 21.02 (2013) ("Vermont Statute"); VA. CODE ANN. § 13.1-782 (2013) ("Virginia Statute"). California's legislation was signed into law on October 9, 2011 and became effective on January 1, 2012. Hawaii's legislation was signed into law on July 8, 2011 and became effective upon signing. Illinois's legislation was signed into law on August 2, 2012 and became effective on January 1, 2013. Louisiana's legislation was signed into law on May 31, 2012 and became effective on August 1, 2012. Maryland's legislation was signed into law on April 13, 2010 and became effective on October 1, 2010. Massachusetts's legislation was signed into law on August 7, 2012 and became effective on December 1, 2012. New Jersey's legislation passed on January 10, 2011 and became effective when it was signed into law on March 1, 2011. New York's legislation was signed into law on December 12, 2011 and became effective on February 10, 2012. Pennsylvania's legislation was signed into law on October 24, 2012 and will become effective on January 22, 2013. South Carolina's legislation was signed into law on June 14, 2012 and became effective upon signing. Vermont's legislation was signed into law on May 19, 2010 and became effective on July 1, 2011. Virginia's legislation was signed into law on March 26, 2011 and became effective on July 1, 2011.

introduced benefit corporation legislation.[52] The following discussion refers to the model benefit corporation legislation attached as Appendix A, hereinafter the "Model Legislation," which reflects the basic structure and content of benefit corporation statutes.[53]

The Model Legislation has been drafted so that the existing corporation code applies to benefit corporations in every respect except those explicitly stipulated in the Model Legislation. This drafting approach avoids the potential legal and administrative issues that will arise in keeping a new corporate form in conformity to the corporation code as changes to the corporation code occur over time.

There are three major provisions in benefit corporation legislation that are consistent from state to state. These provisions address corporate purpose, accountability and transparency, and state that a benefit corporation has: 1) a corporate purpose to create a material positive impact on society and the environment; 2) expanded fiduciary duties of directors which require consideration of non-financial interests; and 3) an obligation to report on its overall social and environmental performance as assessed against a comprehensive, credible, independent and transparent third-party standard.

Thus, among other issues described below, and unlike alternate approaches, the benefit corporation addresses the principal legal impediments, as well as the business and public concerns, described in Sections II and III above.

(A) Existing Benefit Corporation Statutes

1. Election and Disclosure

Electing in or out of benefit corporation status is a voluntary act requiring a two-thirds vote of shareholders.[54] Likewise, in a merger or sale situation, a supermajority shareholder vote

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[52] *See* S.B. 14, Reg. Sess. 2013 (Ala. 2013); H.B. 2276, 51st Leg., First Reg. Sess. 2013 (Ariz. 2013); B19-0584, 19th Council Period (D.C. 2011); H.B. 40, 51st Leg., First Sess. 2013 (N.M. 2013); S.B. 26, 2011-2012 Gen. Assemb., Reg. Sess. (N.C. 2011); S.B. 360, 96th Leg., Reg. Sess. (Mich. 2011); H.B. 2296 and S.B. 144, 77th Or. Leg. Assembly, 2013 Reg. Sess. (Or. 2013). Benefit corporation legislation in Colorado S.B. 11-005, 68th Gen. Assemb., Reg. Sess. (Colo. 2011) has been indefinitely postponed in Colorado's Senate Committee on Business, Labor and Technology, after compromises were made to several major provisions via amendments from the Business Section of the Colorado State Bar.

[53] Benefit corporation legislation varies slightly from state to state based on the individual characteristics of each state's business entity statutory scheme, input from legislators, state bar associations, practitioners, the business community and others. The essential provisions for each state, both where the legislation has been enacted and in those states where it has been introduced, are constant across jurisdictions. The model benefit corporation legislation in Appendix A (hereinafter, the "Model Legislation") collects the best features of the statutes enacted to date and represents the ideal legislation to create benefit corporations.

[54]*See* Model Legislation §§ 104, 105. *See also, e.g.*, MD. CODE ANN., CORPS. & ASS'NS § 5-6C-03(b) (referencing two-thirds standard for amending corporate charters in MD. CODE ANN., CORPS. & ASS'NS § 2-604(e)); VT. STAT. ANN. tit. 11A, § 21.05 (setting two-thirds minimum but permitting higher standard if articles of incorporation so require). *But see* VA. CODE ANN. § 13.1-785 (requiring all shareholders to approve election to benefit corporation status).

would be required if the surviving entity would not be a benefit corporation. [55] A corporation may elect in to benefit corporation status by amending or including in its articles of incorporation a statement that the corporation is a benefit corporation.[56] A benefit corporation may elect out of benefit corporation status by supermajority vote of the shareholders and by deleting the statement that the corporation is a benefit corporation. [57]

2. Corporate Purpose: General Public Benefit

Benefit corporations are required to have a purpose of creating "general public benefit" and are *allowed* to identify one or more "specific public benefit" purposes.[58] This differs from general corporations, which are *allowed* to form for any lawful purpose but have no explicit purpose requirement.

General public benefit is defined as a "material, positive impact on society and the environment, taken as a whole, as assessed against a third-party standard, from the business and operations of a benefit corporation."[59]

The Model Legislation lists seven non-exhaustive possibilities for specific public benefits, which are:

(1) Providing low-income or underserved individuals or communities with beneficial products or services;
(2) Promoting economic opportunity for individuals or communities beyond the creation of jobs in the ordinary course of business;
(3) Preserving the environment;
(4) Improving human health;
(5) Promoting the arts, sciences, or advancement of knowledge;
(6) Increasing the flow of capital to entities with a public benefit purpose; or
(7) The accomplishment of any other particular benefit for society or the environment. [60]

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[55] *See* Model Legislation §§ 104, 105. *See also, e.g.*, MD. CODE ANN., CORPS. & ASS'NS § 5-6C-04(b) (proscribing same § 2-604(e) standard for terminating benefit corporation status).
[56] *See* Model Legislation § 104.
[57] *See* Model Legislation § 105. *See, e.g.*, MD. CODE ANN., CORPS. & ASS'NS § 5-6C-03(a), -04(a). Vermont and New Jersey have similar provisions in their statutes. VT. STAT. ANN. tit. 11A, §§ 21.05, 21.07; N.J. STAT. ANN. §§ 14A:18-2, 18-4. It should also be noted that the benefit corporation legislation is drafted in a way that does not affect general corporations because it permits electing corporations to move in and out of benefit corporations status without changing general corporation standards.
[58] *See* Model Legislation § 201. *See also, e.g.,* MD. CODE ANN., CORPS. & ASS'NS § 5-6C-06(a)(1)-(2), (b)(1).
[59] *See* Model Legislation § 102(a). *See also*, *e.g.*, CAL. CORP. CODE § 14601(c); MD. CODE ANN., CORPS. & ASS'NS § 5-6C-01(b) (slight variation of definition); VT. STAT. ANN. tit. 11A, § 21.03. The New Jersey statute defines general public benefit as " a material positive impact on society and the environment by the operations of a benefit corporation through activities that promote some combination of specific public benefits." N.J. STAT. ANN. § 14A:18-1.
[60] *See* Model Legislation § 102(a). CAL. CORP. CODE § 14601(e). *See also, e.g.*, MD. CODE ANN., CORPS. & ASS'NS § 5-6C-01(d); N.J. STAT. ANN. § 14A:18-1; VT. STAT. ANN. tit. 11A, § 21.03(6).

The Model Legislation explicitly states that "[t]he creation of a general public benefit and specific public benefit . . . is in the best interests of the benefit corporation."[61] This serves to protect against the presumption that the financial interests of the corporation take precedence over the public benefit purposes, which maximizes the benefit corporation's flexibility in corporate decision-making.

3. Accountability: Consideration of Stakeholders

The directors of a benefit corporation, in considering the best interests of the corporation:

> *shall* consider the effects of any action or inaction upon: (i) the shareholders of the benefit corporation, (ii) the employees and workforce of the benefit corporation, its subsidiaries and its suppliers, (iii) the interests of customers as beneficiaries of the general public benefit or specific public benefit purposes of the benefit corporation, (iv) community and societal factors, including those of each community in which offices or facilities of the benefit corporation, its subsidiaries and its suppliers are located, (v) the local and global environment, (vi) the short-term and long-term interests of the benefit corporation, including any benefits that may accrue to the benefit corporation from its long-term plans and the possibility that these interests may be best served by the continued independence of the benefit corporation and (vii) the ability of the benefit corporation to accomplish its general benefit purpose and any specific public benefit purpose.[62]

The statutes also allow directors to consider "any other pertinent factors or the interests of any other group that [the directors] deem appropriate."[63] The stakeholder consideration mandate is an important distinguishing feature from the basic corporation statutes in "constituency" states discussed in Section II above; under constituency statutes, the consideration of non-shareholder interests is permissive, while under the Model Legislation it is mandatory.

4. Transparency: Third-Party Standard and Overall Performance

A benefit corporation is required to deliver an annual benefit report to the shareholders and to post it on its website so it is available to the public.[64] The report must be filed with a department of the state.[65]

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[61] *See* Model Legislation § 201(c).

[62] *See* Model Legislation § 301(a)(1). *See also, e.g.,* MD. CODE ANN., CORPS. & ASS'NS § 5-6C-07(a)(1); VT. STAT. ANN. tit. 11A, § 21.09(a)(1)(F); N.J. STAT. ANN. § 14A:18-6(a)(6).

[63] *See* Model Legislation § 301(a)(2). *See also, e.g.*, MD. CODE ANN., CORPS. & ASS'NS § 5-6C-07(a)(2). Vermont and New Jersey have similar provisions. VT. STAT. ANN. tit. 11A, § 21.09(a)(2); N.J. STAT. ANN. § 14A:18-6(b)(2).

[64] *See* Model Legislation § 401(b)-(c). *See also*, *e.g.,* MD. CODE ANN., CORPS. & ASS'NS § 5-6C-08(a); N.J. STAT. ANN. § 14A:18-11(c); VT. STAT. ANN. tit. 11A, § 21.14(d). Not all states require a benefit report to be filed with a department of the state.

[65] *See* Model Legislation § 401(e). *See also*, *e.g.*, N.J. STAT. ANN. § 14A-18-11(d); S.B. 79-A, 2011-2012 Gen. Assemb., Reg Sess. (N.Y. 2011).

The report must include a narrative description of the ways in which the benefit corporation pursued a general public benefit and the extent to which it was created, the ways the benefit corporation pursued any specific benefit (if stated in the company's articles) and the extent to which it was created, any circumstances that may have hindered creation of general public benefit or specific public benefit and the process and rationale for selecting or changing the third-party standard used to prepare the benefit report.[66]

In addition to disclosure requirements about the material shareholders of the benefit corporation and a statement of any connection of the benefit corporation to the third-party standard, the report must also include "an assessment of the overall social and environmental performance of the benefit corporation against a third-party standard applied consistently with any application of that standard in prior benefit reports or accompanied by an explanation of the reasons for any inconsistent application."[67]

Since in many ways the third-party standard is the heart of benefit corporation legislation(and for many observers, the most contentious and misunderstood provision in benefit corporation legislation), presented below from the Model Legislation is a full definition of third-party standard and a full description of the reporting requirements for benefit corporations, for which the third-party standard is essential. A full discussion of the rationale behind the third-party standard is presented below in Section IV.

"Third-party standard" is defined as "a recognized standard for defining, reporting and assessing overall corporate social and environmental performance" which is:

(1) Comprehensive in that it assesses the effect of the business and its operations upon the interests listed in section 301(a)(1)(ii), (iii), (iv) and (v).

(2) Developed by an organization that is independent of the benefit corporation and satisfies the following requirements:

(i) Not more than one-third of the members of the governing body of the organization are representatives of any of the following:

Governing Body = BOD?

(A) An association of businesses operating in a specific industry the performance of whose members is measured by the standard.

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[66] *See* Model Legislation § 401(a). *See also, e.g.,* CAL. CORP. CODE § 14630(a)(1)(A); S.B. 79-A, 2011-2012 Gen. Assemb., Reg Sess. (N.Y. 2011). Other states have similar variations of this provision. *See, e.g.,* MD. CODE ANN., CORPS. & ASS'NS § 5-6C-08(a)(1)(i)-(iii); N.J. STAT. ANN. § 14A:18-11(a)(1)(a)-(c); VT. STAT. ANN. tit. 11A, § 21.14(a)(1)(A)-(C). Vermont benefit corporations must additionally suggest specific actions the benefit corporation can take to improve upon the attainment of its identified goals, VT. STAT. ANN. tit. 11A, § 21.14(a)(1)(D), and shareholders must approve or reject the annual benefit report by majority vote. VT. STAT. ANN. tit. 11A, § 21.14(a)(7).

[67] *See* Model Legislation § 401(a)(2). *See also*, e.g., MD. CODE ANN., CORPS. & ASS'NS § 5-6C-08(a)(2); N.J. STAT. ANN. § 14A:18-11(a)(2); VT. STAT. ANN. tit. 11A, § 21.14(a)(2).

(B) Businesses from a specific industry or an association of businesses in that industry.

(C) Business whose performance is assessed against the standard.

(ii) The organization is not materially financed by an association or business described in subparagraph (i).

(3) Credible because the standard is developed by a person that both:

(i) Has access to necessary expertise to assess overall corporate social and environmental performance.

(ii) Uses a balanced multistakeholder approach, including a public comment period of at least 30 days to develop the standard.

(4) Transparent because the following information is publicly available:

(i) About the standard:

(A) The criteria considered when measuring the overall social and environmental performance of a business.

(B) The relative weightings, if any, of those criteria.

(ii) About the development and revision of the standard:

(A) The identity of the directors, officers, material owners and the governing body of the organization that developed and controls revisions to the standard.

(B) The process by which revisions to the standard and changes to the membership of the governing body are made.

(C) An accounting of the sources of financial support for the organization, with sufficient detail to disclose any relationships that could reasonably be considered to present a potential conflict of interest.[68]

How many third party standards satisfy this definition beyond BIA?

By assessing and disclosing the benefit corporation's overall social and environmental performance against an independent third-party standard, shareholders and the public are provided an easy way to evaluate the company on these criteria, which for typical companies, is otherwise almost impossible to determine. Based upon the research cited in Section II, it is

[68] *See* Model Legislation § 102(a). *See also, e.g.,* CAL. CORP. CODE § 14601(g) (2011). Similar third party standards have been included in the legislation introduced in Pennsylvania, Illinois, Colorado, Washington and the District of Columbia.

anticipated that this simplified "due diligence" tool will facilitate greater investment in benefit corporations and improve customer loyalty by enabling consumers to differentiate good deeds from merely good marketing. Over time, this has the potential to create market-driven positive feedback loops rewarding companies that adopt this higher standard of corporate governance and demonstrate higher levels of overall social and environmental performance.

5. Scope of Director Liability

Directors of benefit corporations are afforded certain protections under the Model Legislation. First, the Model Legislation expressly states that the consideration of all stakeholders shall not constitute a violation of the general standards for directors, which require good faith, the care of an ordinarily prudent person and the consideration of the best interests of the corporation.[69] In an effort to restrict potential liability, the Model Legislation specifically excludes director, officer and corporate liability for monetary damages.[70] This decision was driven by twin desires to (i) eliminate concerns of directors that they will be subject to personal liability in the face of no court precedent by which such liability could be quantified and (ii) focus courts on the exclusive remedy of awarding injunctive relief requiring the benefit corporation to simply live up to the commitments it voluntarily undertook.[71]

Directors are also protected from suits by beneficiaries of the corporation's public purpose. The Model Legislation expressly states that third parties have no right of action. The Model Legislation further states that it does not create a fiduciary duty to anyone who cannot bring a "benefit enforcement proceeding."[72] Benefit enforcement proceedings are a right of action only for shareholders, directors, investors in the parent company of a benefit corporation subsidiary with a 5% or more equity interest, and any other persons specified in the company's articles of incorporation.[73]

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[69] *See* Model Legislation § 301(b)(1). *See also*, *e.g.*, MD. CODE ANN., CORPS. & ASS'NS § 5-6C-07(c) (referencing general standards for director conduct under § 2-405.1); N.J. STAT. ANN. § 14A:18-6(b)(1) (referencing general standard under § 14A:6-1); VT. STAT. ANN. tit. 11A, § 21.09(b) (referencing general standard of care under § 11A:8.30).

[70] *See* Model Legislation § 301(c), 303(c) and 305(a)(2).

[71] The Model Legislation, as well as Vermont, California and New Jersey statutes, make clear that, unless expressly provided in the company's articles of incorporation, the directors are not required to give priority to the interests of any particular person or group referred to in the statute over any other person or group. *See* Model Legislation § 301(3); CAL. CORP. CODE § 14620(d), available at 2011 Cal. Legis. Serv. Ch. 728 (A.B. 361) (filed with the Secretary of State, October 9, 2011; to be codified); N.J. STAT. ANN. § 14A:18-6(c); VT. STAT. ANN. tit. 11A, § 21.09(a)(3). The Vermont statute further provides that a director shall not be subject to a different or higher standard of care in a potential change of control situation (e.g., the *Unocal* or *Revlon* situations discussed in Section III above). VT. STAT. ANN. tit. 11A, § 21.09(a)(4). The Vermont and New Jersey statutes also make clear that a director will not be liable for the failure to actually create a general or specific public benefit. N.J. STAT. ANN. § 14A:18-6(d); VT. STAT. ANN. tit. 11A, § 21.09(c).

[72] *See* Model Legislation § 301(d). *See also, e.g.,* VT. STAT. ANN. tit. 11A, § 21.09(e); MD. CODE ANN., CORPS. & ASS'NS § 5-6C-07(b); N.J. STAT. ANN. § 14A:18-10(a)-(b).

[73] *See* Model Legislation § 305(a). *See also, e.g.*, N.J. STAT. ANN. § 14A:18-10(b); VT. STAT. ANN. tit. 11A, § 21.13(b).

A shareholder is expressly given the right to bring a legal action on the basis that a director or officer failed to pursue or create the stated general or specific public benefit purposes, failed to *consider* the interests of the various stakeholders set forth in the statute, or failed to meet the transparency requirements in the statute.[74] For reasons stated in Section III, this expanded accountability to shareholders is specifically desired by most of the mission-driven entrepreneurs and investors interested in new corporate form legislation. Similarly, the exclusion of any right of action by third parties protects the benefit corporation from unknown, expanded liability that would otherwise operate as a disincentive to becoming a benefit corporation.

6. Benefit Director

A "benefit director" is a director who is specifically designated to oversee benefit issues.[75] This director is responsible for preparing the annual benefit report and preparing a statement for inclusion in the annual report of whether, in the opinion of the benefit director, the benefit corporation acted in accordance with its general public benefit purpose and any specific benefit purpose.[76]

IV. Drafting Analysis of Particular Benefit Corporation Statutory Provisions

Questions have sometimes arisen, particularly as states begin to consider enactment of their own benefit corporation legislation, as to why particular provisions of the benefit corporation legislation were drafted they way they were and what the implications of these provisions might be. The following discussion addresses some of these questions.

(A) General Public Benefit Requirement

1. General vs. Specific

Some observers have questioned why the statute should require the creation of "general public benefit" rather than simply the creation of one or more "specific public benefits."

The first reason is directly related to the purpose of the legislation itself. One of the main purposes of benefit corporation legislation is to create a voluntary new corporate form that has the corporate purpose to create benefit for society and the environment generally as well as shareholders. The entrepreneurs, investors, consumers and policy makers interested in new corporate form legislation are not interested in, for example, reducing waste while increasing carbon emissions, or reducing both while remaining indifferent to the creation of economic opportunity for low-income individuals or underserved communities. They are interested in creating a new corporate form that gives entrepreneurs and investors the flexibility and

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[74] *See* Model Legislation § 305(a). *See also, e.g.*, N.J. STAT. ANN. § 14A:18-10(b); VT. STAT. ANN. tit. 11A, § 21.13(b).
[75] *See* Model Legislation § 302 (a). Some states have incorporated benefit director provisions into their benefit corporation legislation. *See*, *e.g.*, N.J. STAT. ANN. § 14A:18-1; VT. STAT. ANN. tit. 11A, § 21.03(a)(2). In other states, the benefit director's duties are shared by the entire board. *See, e.g.,* California Statute.
[76] *See* Model Legislation § 302(a). *See also, e.g.,* N.J. STAT. ANN. § 14A:18-7(c); VT. STAT. ANN. tit. 11A, § 21.10.

protection to pursue all of these public benefit purposes. The best way to give them what they need is to create a corporate form with a general public benefit purpose.

The second reason is to avoid unintended consequences. The "general public benefit" purpose helps to prevent abuse of the legislation by corporations interested in "greenwashing." Without the general public benefit purpose, a corporation could name a single, narrow "specific public benefit" purpose (e.g., keeping the river in back of the factory free from toxic effluents) and then "consider" and dismiss all other non-financial interests when making decisions. This would undermine one of the main purposes of the legislation, namely the creation of a new corporate form whose corporate purpose is to create benefit for society generally.

2. Flexibility and Legislating Morality

Some have expressed concern that the definition of general public benefit is prescriptive, lacks flexibility and legislates morality. In fact, the legislation does the opposite specifically through the general public benefit provision that recognizes that different companies will pursue the creation of a material positive impact on society and the environment in a variety of ways. A general public benefit provision encourages flexibility and enables innovation by simply setting a "directional" performance requirement (i.e., "material positive impact on society and the environment") without creating unnecessarily prescriptive performance requirements (e.g., achieve zero waste or be carbon neutral).

3. "Create" vs. "Pursue" and Directors Liability

Some observers have expressed concern that directors of benefit corporations would be exposed to liability if the benefit corporation did not "create a material positive impact on society and the environment." The Model legislation specifically states that a benefit enforcement proceeding can only be brought for a "failure to pursue or create general public benefit or a specific public benefit purpose set forth in its articles; or violation of a duty or standard of conduct under the [chapter]."[77] This provision must be read and understood in conjunction with the inclusion of the provision that makes clear that directors and officers are not liable for monetary damages.[78] By including both the failure to "create" and "pursue," the drafters intended to clarify that the benefit enforcement proceeding is intended to be the sole cause of action available to shareholders with respect to general and specific public benefit purpose and that monetary damages are not available as a remedy.

4. Positive Impact vs. Net Impact

Some observers have expressed concern that "material positive impact" takes no account of potential "negative impacts" of the business or operations of a benefit corporation. This is true and intentional. A "net positive impact" would imply that one could add and subtract impacts from diverse activities (e.g., add 2 units for reducing energy usage per unit of production, subtract 1 unit for a discrimination lawsuit, etc.) based upon some common unit of

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[77] *See*, *e.g.*, VA. CODE ANN. § 13.1-782 (West 2011).
[78] *See infra* Section V.E.

measure. Such a unit of measure does not exist and is unlikely to exist at least for a considerable period of time. Rather, the legislation recognizes that numerous existing standards already aggregate diverse corporate activities into an overall assessment for a corporation's social and environmental performance. This is an important first step that, when coupled with the legislation's requirement that the benefit corporation's performance be assessed against a comprehensive, credible, independent, and transparent third-party standard, moves the market closer to a desired "net impact" assessment.

5. Society and the Environment vs. Society or the Environment

Some observers have been concerned that the requirement to create "a material positive impact on society and the environment" places too high a burden on benefit corporations in that very few businesses can do both. For this reason, the model benefit corporation legislation includes the phrase "taken as a whole" after "society and the environment" so that the legislation's intent is clear that, as the corporate purpose ought to be to create general rather than specific public benefit, the assessment of the benefit corporation's pursuit of this objective should also be "taken as a whole" as it relates to both social and environmental impact.

6. Interpreting "Material Positive Impact"

Some observers have expressed a concern that the requirement for a benefit corporation to create a "material positive impact on society and the environment" is too vague, and the concept of "general public benefit" too broad to be meaningful. To address this concern, the Model Legislation provides for this requirement to be assessed against a comprehensive, credible, independent and transparent third-party standard. The comprehensive criteria specifically ensures that the corporation's impact on each of the non-financial interests that directors are required to consider are assessed in the annual benefit report. The Model Legislation thus strikes a balance between specifically enumerating those interests to be considered and linking them to those impacts to be assessed without being overly prescriptive in listing specific metrics to be used to make those assessments or to weight those metrics or interests.

Furthermore, legislation with more prescriptive performance criteria would likely have several problems. First, as a general matter it would likely make legislation more difficult to pass as special interests attach an increasingly cumbersome series of narrow and likely contentious performance standards and a list of prohibited activities. Such prescription would have the undesirable effect of presuming a capacity in (and desirability for) government to establish and administer performance standards across a wide range of corporate activities, or would require legislators to "anoint" one or more third-party standards and/or appoint and fund a government entity to administer accreditation. Such an approach would also potentially have a chilling effect on market innovation to develop generally accepted performance standards. All of the foregoing ultimately undermine the objectives of the legislation, as fewer companies could be expected to adopt a new corporate form with a cumbersome list of prescriptive and prohibited activities.

It has also been suggested by some observers that without more prescriptive performance standards the benefit corporation would just become a legalized form of "greenwashing." This observation is simply at odds with the legislation. A company deciding to become a benefit corporation will necessarily be legally required to meet higher standards of corporate purpose, accountability and transparency. Unlike existing corporations, benefit corporations can be held liable for the failure to pursue the purpose of creating a material positive impact on society and the environment as measured by an independent third-party standard and for the failure to consider the enumerated mandatory stakeholder interests. Benefit corporations are required to publish publicly on an annual basis a benefit report in accordance with recognized standards for assessing social and environmental performance, including an assessment of its successes and failures in achieving its public benefit purpose and in considering effects of decisions on stakeholders. The requirement to have a benefit director is an additional legal requirement designed to ensure that the general and specific public benefit purposes are pursued.

(B) Consideration of Stakeholder Interests

It is important to note that shareholders are among the stakeholders whose interests the directors of a benefit corporation are required to consider; in fact they are listed first, and remain the only stakeholder entitled to bring a legal action against the corporation or its directors. Therefore, directors of benefit corporations may not simply disregard financial stakeholders in pursuing their stated purpose; rather they must balance the interests of shareholders as financial stakeholders with the enumerated other interests.

While a shareholder of a benefit corporation could still bring a traditional action for the failure of the directors to adequately consider shareholder financial interests, such a shareholder could also now bring a benefit enforcement proceeding for failure to consider other stakeholder interests, e.g., for failure of the directors to adequately consider the impact of a particular action on the workforce of the company. While this grants shareholders an expanded right of action, it is important to note that the consideration standard does not require a particular outcome of the directors' decision-making, but rather that there is a decision-making process that considers all of the enumerated stakeholders.

(C) Importance of Third-Party Standards

The requirement that the annual benefit report assess the overall social and environmental performance of the benefit corporation against a third-party standard is an essential requirement of the Model Legislation. Below is a discussion of concerns that have been expressed regarding the third-party standard requirement

1. Choice

The Model Legislation does not require a benefit corporation to use any particular third-party standard to prepare its benefit report. There are many third-party standards organizations that meet the statutory criteria for a third party standard to be comprehensive, credible, independent, and transparent. The Global Reporting Initiative (GRI), GreenSeal, Underwriters Laboratories (UL), ISO2600, Green America and B Lab are a few well-known examples. Both GRI and B Lab offer companies the use of their reporting (GRI) and assessment (B Lab) tools for free. In addition to the examples listed above, more than 100 "raters" of corporate sustainability practices are listed in the "Rate the Raters" report published by the research and consulting firm SustainAbility. This list is available for free at http://www.sustainability.com/library/rate-the-raters-phase-two. The management, and ultimately, directors and shareholders, of benefit corporations are free to decide for themselves which of these or other standards they feel meet the statutory requirements and their needs.

While allowing benefit corporations to choose a third party standard against which they will assess their overall social and environmental performance, to guard against "greenwashing," the Model Legislation provides management, directors, shareholders, and ultimately judges, criteria for what constitutes an acceptable third-party standard. This definition of third party standard is the result of research into the criteria used by international standards organizations (e.g., American National Standards Institute, International Standards Organization, ISEAL) and regulatory bodies (e.g., U.S. Federal Trade Commission) to identify high quality standards and certifications.

2. Verification

Benefit corporations are not required to have their benefit report certified or audited by a third party. Mandatory verification has been omitted from the requirements for an acceptable third-party standard for several reasons.

First, mandatory verification would place a cost burden on benefit corporations to meet the reporting requirements of the statute. While free third-party standards exist that can be used to generate a benefit report, no third-party standard provider will perform verification services for free. Requiring annual verification would impose a cost that would greatly reduce adoption, particularly among small businesses interested in new corporate form legislation.

Second, while SEC rules do require audited financial reports of publicly-traded companies, ordinary corporations are not required under state corporate statutes to have audited financial reports and benefit corporations should not be required to have audited benefit reports of their social and environmental performance.

Third, directors of benefit corporations are already subject to litigation for fraud if they report false or intentionally misleading information in their benefit report.

Finally, verification can and will become a means by which certain benefit corporations distinguish themselves on a competitive basis to attract greater confidence in their claims of environmental and social performance.

3. Accreditation

Mandatory accreditation of the third-party standard by the American National Standards Institute (ANSI) or other national or international standards bodies has been omitted from the criteria for an acceptable third-party standard for several reasons.

First, mandatory accreditation creates a likely monopoly for ANSI or creates costs for a government regulatory body to determine which organizations would qualify as approved accreditation bodies. It seemed more appropriate to strengthen the definitions of "credible" and "independent" to include as many of the criteria as practicable currently cited by ANSI and other international standards organizations as best practice among standards developers. This promotes a proliferation of standards and competition among them so that the market can select the best ones.

Second, since ANSI would likely be the sole accreditor of developers, the ANSI requirement that accredited developers conform with a consensus approach requiring a two-thirds vote of the governing body to approve or revise the standard seems overly restrictive in the governance of a standard for assessing overall corporate social and environmental performance in which a greater diversity of experience and opinion will necessarily exist among members of the governing body than would be the case in a governing body for a single industry or attribute standard, which are more typical of existing ANSI accredited standards and standard developers. It seems more appropriate that a simple majority vote of the governing body would be appropriate in the instance of a third-party standard for benefit corporations.

Third, the ANSI consensus approach requirement also requires significant written documentation of objections and efforts to respond to objections which would place a significant burden on standards developers for overall corporate social and environmental performance given the early stage of development of this area of standards development. For this reason alone, many highly respected standards have forsaken the ANSI process because it enables detractors to slow down the standards development process while increasing costs, both of which often run counter to the objectives for which these standards are created. It seems more appropriate to strengthen the definition of an acceptable third-party standard through other means such as more detailed requirements regarding the standards' comprehensiveness, credibility, independence and transparency and additional disclosure requirements within the annual benefit report.

4. Independence

The definition of "independent" reflects consideration of important criteria regarding governance, transparency and reporting.

First, regarding governance, to ensure a balanced approach to the weighting, evolution and application of the standard, no industry group, trade association or individual interests assessed by the third-party standard can represent more than one-third of the controlling interest of the governing body of the standard.

Second, regarding transparency, to ensure that potential financial influence is disclosed, an accounting of the sources of financial support for the standard organization, including but not limited to fees, grants, investments and material in-kind support, with sufficient detail to disclose any relationships which could reasonably be considered to present a potential conflict of interest, must be made publicly available.

Third, regarding reporting, the benefit corporation is required to include in its annual benefit report a statement of any connection to the third-party standard, or its directors officers, or material owners from the benefit corporation, or its directors, officers, and material owners, including any financial or governance relationship that might materially affect the credibility of the objective assessment of the third-party standard.

(D) Dissenters' Rights

Because the Model Legislation works within the existing corporate statutory framework, the Model Legislation conforms its treatment of dissenters' rights with respect to amendments of the articles and to the way they are already treated under a particular state's corporate code. Thus, in states where dissenters' rights exist, they exist in the same situations for shareholders of benefit corporations. In states where dissenters' rights do not exist for amendments of the articles or mergers, dissenters' rights are not given to shareholders of benefit corporations.

The Model Legislation does not create specific dissenters rights for the election or termination of status where they would not otherwise exist.[79] Unlike in events that typically trigger dissenters' rights, opting in or out of benefit corporation status is not a liquidity event that provides a pool of cash to satisfy existing shareholders. Instead, any cash to be paid to shareholders would be required to come from the corporation itself. Since most businesses interested in new corporate form legislation are private, small, and growing ("cash-poor"), the existence of dissenters' rights where none existed prior would have a chilling effect on adoption. By requiring a higher two-thirds supermajority shareholder vote to opt in or out, instead of a typical simple majority vote required for changes of corporate structure or control, Model Legislation raises the standard without making it unnecessarily difficult and ultimately limiting the legislation's effectiveness.

(E) Remedies

Observers, as well as early adopters and attorneys advising them, have asked, "For what remedies might a shareholder sue?" As this is a new corporate form, there is no case law from which to provide authoritative answers.

In an effort to restrict potential liability, the Model Legislation specifically excludes director, officer and corporate liability for monetary damages.[80] As mentioned in Section III above, this decision was driven by the twin desires to (i) eliminate such concern in the face of no court precedent by which such liability could be quantified and (ii) to focus courts on the exclusive remedy of awarding injunctive relief to require the benefit corporation to simply live up to its voluntary commitments.

While the following is purely hypothetical, below are some thoughts on the issue of remedies in different "benefit enforcement proceedings."

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[79] Only California has specifically included a provision in its legislation granting dissenter's rights based on benefit corporation status. *See* California Statute. Virginia does not provide for dissenter's rights, but does require that the benefit corporation status be approved by 100% of the shareholders. *See* Virginia Statute.

[80] *See*, *e.g.*, CAL. CORP. CODE § 14620(f), available at 2011 Cal. Legis. Serv. Ch. 728 (A.B. 361) (filed with the Secretary of State, October 9, 2011; to be codified).

1. Purpose

The most difficult obligation for a court to enforce would be the requirement that the corporation "pursue the creation of a material positive impact on society and the environment, taken as a whole, as assessed against a third-party standard." If the corporation could show a meaningful good faith effort to pursue such positive impacts, then a judge would likely be reticent to interpose his or her judgment for the corporation's. Absent such effort, a judge might give directors a fixed period of time to undertake such action, which could perhaps be demonstrated by the corporation achieving a higher performance level under the third-party standard it had applied in earlier benefit reports.

2. Accountability

If directors were found to have violated their duty to consider stakeholder interests, a judge might give directors a fixed period of time to do some or all of the following: 1) consider the issue(s) deemed to have not been adequately considered and 2) implement a policy to ensure adequate consideration is made in future decisions.

3. Transparency

If directors were found to have failed to meet the transparency requirements of benefit corporation legislation, a judge might give directors a fixed period of time to publically publish a benefit report that meets the statutory requirements.

(F) Access to Capital

Benefit corporations are able to attract the same types of capital as regular corporations. Additionally, for reasons described in Section II, benefit corporations can be expected to be more successful in accessing socially responsible or impact investments, because in contrast to alternative new business forms benefit corporations have more consistent, clear and flexible statements of purpose and more robust accountability and transparency mechanisms for those purposes. Lastly, for reasons also described in Section I, benefit corporations may even be more attractive to mainstream capital providers as they increasingly incorporate integrated social and environmental factors into their investment decisions.

V. <u>Conclusion</u>

Benefit corporations best meet the needs of entrepreneurs, investors, consumers and policy makers interested in using the power of business to solve social and environmental problems. Benefit corporations offer clear market differentiation, broad legal protection to directors and officers, expanded shareholder rights and greater access to capital than other new corporate forms.

The sustainable business movement, impact investing and social enterprise sectors are developing rapidly but are constrained by an outdated legal framework that is not equipped to accommodate for-profit entities whose social benefit purpose is central to their existence. The benefit corporation, which has already been established by statute in seven states and which is the subject of legislative initiatives in several others, is the most comprehensive yet flexible legal entity devised to address the needs of entrepreneurs and investors and, ultimately, the general public. As a result, it has also attracted broad support from entrepreneurs, investors, citizens and policy makers interested in new corporate form legislation.

Attorneys and members of the bar associations of the various states are encouraged to express their views on the matters discussed herein and, to the extent there is concurrence, to sign on to the views expressed in this paper.

Additional information on benefit corporations is available at www.benefitcorp.org. This website is administered as a service at no cost to the public by the 501(c)(3) nonprofit organization B Lab. For further information please contact info@benefitcorp.org.

Appendix A

MODEL BENEFIT CORPORATION LEGISLATION

With Explanatory Comments[81]

[*Chapter*] __
Benefit Corporations

[*Subchapter*]
1. Preliminary Provisions
2. Corporate Purposes
3. Accountability
4. Transparency

[*Subchapter*] 1
Preliminary Provisions

Section
101. Application and effect of [*chapter*].
102. Definitions.
103. Incorporation of benefit corporation.
104. Election of benefit corporation status.
105. Termination of benefit corporation status.

§ 101. Application and effect of [*chapter*].

(a) General rule. – This [*chapter*] shall be applicable to all benefit corporations.

(b) Application of business corporation law generally. – The existence of a provision of this [*chapter*] shall not of itself create an implication that a contrary or different rule of law is applicable to a business corporation that is not a benefit corporation. This [*chapter*] shall not affect a statute or rule of law that is applicable to a business corporation that is not a benefit corporation.

(c) Laws applicable. – Except as otherwise provided in this [*chapter*], [*the enacting state's business corporation law*] shall be generally applicable to all benefit corporations. The specific provisions of this [*chapter*] shall control over the general provisions of [*cite the business*

[81] For a detailed discussion of the issues to be considered when preparing legislation for introduction in a state see Clark et al, *The Need and Rationale for the Benefit Corporation* (2011), available at www.benefitcorp.org. See generally, William H. Clark, Jr. and Elizabeth K. Babson, "*How Benefit Corporations are Redefining the Purpose of Business Corporations*," 38 WM. MITCHELL L. REV. 817 (2012).

corporation law]. A benefit corporation may be subject simultaneously to this [*chapter*] and one or more other [*cite any statutes that provide for the incorporation of a specific type of business corporation, such as a professional corporation*].

(d) Organic records. – A provision of the articles of incorporation or bylaws of a benefit corporation may not limit, be inconsistent with, or supersede a provision of this [*chapter*].

Comment:

This chapter authorizes the organization of a form of business corporation that offers entrepreneurs and investors the option to build, and invest in, businesses that operate with a corporate purpose broader than maximizing shareholder value and a responsibility to consider the impact of its decisions on all stakeholders, not just shareholders. Enforcement of those duties comes not from governmental oversight, but rather from new provisions on transparency and accountability included in this chapter.

The last sentence of subsection (c) makes clear that if a state provides for the incorporation of specialized types of business corporations, such as statutory close corporations, insurance corporations, or professional corporations, those corporations may also be benefit corporations. In the case of a professional corporation, section 201(e) provides a special rule that eliminates any conflict between this chapter and the requirement found in many professional corporation laws that limits the purposes or business of a professional corporation to providing a particular type of professional service.

As a result of subsection (d), a corporation that elects to be subject to this chapter will be subject to all of the provisions of the chapter and will not be able to vary their application to the corporation.

The term "benefit corporation" used in this section is defined in section 102.

§ 102. Definitions.

The following words and phrases when used in this [*chapter*] shall have the meanings given to them in this section unless the context clearly indicates otherwise:

"Benefit corporation." A business corporation:

(1) which has elected to become subject to this [*chapter*]; and

(2) the status of which as a benefit corporation has not been terminated.

"Benefit director." [*Either:*]

[*(1)*] the director designated as the benefit director of a benefit corporation under section 302[*; or*

(2) a person with one or more of the powers, duties or rights of a benefit director to the extent provided in the bylaws under section 302(f)].

"Benefit enforcement proceeding." Any claim or action or proceeding for:

(1) failure of a benefit corporation to pursue or create general public benefit or a specific public benefit purpose set forth in its articles; or

(2) violation of any obligation, duty, or standard of conduct under this [*chapter*].

"Benefit officer." The individual designated as the benefit officer of a benefit corporation under section 304.

"General public benefit." A material positive impact on society and the environment, taken as a whole, assessed against a third-party standard, from the business and operations of a benefit corporation.

"Independent." Having no material relationship with a benefit corporation or a subsidiary of the benefit corporation. Serving as benefit director or benefit officer does not make an individual not independent. A material relationship between an individual and a benefit corporation or any of its subsidiaries will be conclusively presumed to exist if any of the following apply:

(1) The individual is, or has been within the last three years, an employee other than a benefit officer of the benefit corporation or a subsidiary.

(2) An immediate family member of the individual is, or has been within the last three years, an executive officer other than a benefit officer of the benefit corporation or a subsidiary.

(3) There is beneficial or record ownership of 5% or more of the outstanding shares of the benefit corporation, calculated as if all outstanding rights to acquire equity interests in the benefit corporation had been exercised, by:

(i) the individual; or

(ii) an entity:

(A) of which the individual is a director, an officer, or a manager; or

(B) in which the individual owns beneficially or of record 5% or more of the outstanding equity interests, calculated as if all outstanding rights to acquire equity interests in the entity had been exercised.

"Minimum status vote."

(1) In the case of a business corporation, in addition to any other required approval or vote, the satisfaction of the following conditions:

(i) The shareholders of every class or series shall be entitled to vote as a [*separate voting group*] [*class*] on the corporate action regardless of a limitation stated in the articles of incorporation or bylaws on the voting rights of any class or series.

(ii) The corporate action must be approved by vote of the shareholders of each class or series entitled to cast at least two-thirds of the votes that all shareholders of the class or series are entitled to cast on the action.

[*(2) In the case of a domestic entity other than a business corporation, in addition to any other required approval, vote, or consent, the satisfaction of the following conditions:*

(i) The holders of every class or series of equity interest in the entity that are entitled to receive a distribution of any kind from the entity shall be entitled to vote on or consent to the action regardless of any otherwise applicable limitation on the voting or consent rights of any class or series.

(ii) The action must be approved by vote or consent of the holders described in subparagraph (i) entitled to cast at least two-thirds of the votes or consents that all of those holders are entitled to cast on the action.]

"Publicly traded corporation." A business corporation that has shares listed on a national securities exchange or traded in a market maintained by one or more members of a national securities association.

"Specific public benefit." Includes:

(1) providing low-income or underserved individuals or communities with beneficial products or services;

(2) promoting economic opportunity for individuals or communities beyond the creation of jobs in the normal course of business;

(3) protecting or restoring the environment;

(4) improving human health;

(5) promoting the arts, sciences, or advancement of knowledge;

(6) increasing the flow of capital to entities with a purpose to benefit society or the environment; and

(7) conferring any other particular benefit on society or the environment.

"Subsidiary." In relation to a person, an entity in which the person owns beneficially or of record 50% or more of the outstanding equity interests.

"Third-party standard." A recognized standard for defining, reporting, and assessing corporate social and environmental performance that is:

(1) Comprehensive because it assesses the effect of the business and its operations upon the interests listed in section 301(a)(1)(ii), (iii), (iv) and (v).

(2) Developed by an entity that is not controlled by the benefit corporation.

(3) Credible because it is developed by an entity that both:

(i) has access to necessary expertise to assess overall corporate social and environmental performance; and

(ii) uses a balanced multistakeholder approach to develop the standard, including a reasonable public comment period.

(4) Transparent because the following information is publicly available:

(i) About the standard:

(A) The criteria considered when measuring the overall social and environmental performance of a business.

(B) The relative weightings, if any, of those criteria.

(ii) About the development and revision of the standard:

(A) The identity of the directors, officers, material owners, and the governing body of the entity that developed and controls revisions to the standard.

(B) The process by which revisions to the standard and changes to the membership of the governing body are made.

(C) An accounting of the revenue and sources of financial support for the entity, with sufficient detail to disclose any relationships that could reasonably be considered to present a potential conflict of interest.

Comment:

"Benefit corporation." The provisions of this chapter apply to a business corporation while it has the status of a benefit corporation because its articles contain a statement that it is a benefit corporation. If that statement is deleted under section 105(a), the corporation will cease to be a benefit corporation immediately upon the effectiveness of the deletion.

"Benefit director." Paragraph (2) of this definition should be used in states that permit a corporation to provide that the functions of the board of directors will be discharged by persons other than directors. *See* section 302(f). *See also* section 401(a)(8) which requires a benefit corporation that has so varied its governance to describe the alternative arrangements in its annual benefit report.

"Benefit enforcement proceeding." This definition not only describes the action that may be brought under section 305, but it also has the effect of excluding other actions against a benefit corporation and its directors and officers because section 305(a)(1) provides that "no person may bring an action or assert a claim against a benefit corporation or its directors or officers" with respect to violation of the provisions of this chapter except in a benefit enforcement proceeding.

The obligations that may be enforced through a benefit enforcement proceeding include the obligations of a benefit corporation under section 401(c) to post its benefit reports on its Internet website and to supply copies of its benefit report if it does not have an Internet website. In the case of a failure to provide a copy of a benefit report, a benefit enforcement proceeding to enforce that obligation may only be brought by the persons listed in section 305 and not by the person requesting the copy of the report.

"General public benefit." By requiring that the impact of a business on society and the environment be looked at "as a whole," the concept of general public benefit requires consideration of all of the effects of the business on society and the environment. What is involved in creating general public benefit is informed by section 301(a) which lists the specific interests that the directors of a benefit corporation are required to consider.

"Minimum status vote." An amendment of the articles or a fundamental change that has the effect of changing the status of a corporation so that it either becomes a benefit corporation or ceases to be a benefit corporation must be approved by the minimum status vote. *See* sections 104 and 105. The purpose of requiring a two-thirds vote under this chapter is to ensure that there is broad shareholder support for an action. This definition will not be needed in states that require a supermajority vote of two-thirds or more for amendments of the articles or fundamental changes.

The second paragraph of the definition extends its policy to other forms of entities so that, for example, a merger of a limited liability company into a benefit corporation must be approved by the members of the limited liability company by at least a two-thirds vote. The second paragraph should be omitted by those states that require a supermajority vote of two-thirds or more by the owners of an unincorporated entity to approve a fundamental change. See, e.g., Uniform Limited Liability Company Act (2006) § 1003, which requires a unanimous vote by the members of a limited liability company to approve a merger.

The two-thirds vote required by the definition is in addition to any other vote required in the case of any particular corporation or other form of entity. If the articles of a corporation were to require, for example, an 80% supermajority vote to approve a merger, a 70% vote to approve a merger of the corporation into a benefit corporation would be sufficient to satisfy the requirement that the merger be approved by the minimum status vote but would not be sufficient for valid approval of the merger.

"Publicly traded corporation." This definition is used in section 302 and makes the requirement of a benefit director mandatory for publicly traded corporations. The definition is patterned after Model Business Corporation Act § 1.40(18A) (2010).

"Specific public benefit." Every benefit corporation has the purpose under section 201(a) of creating general public benefit. A benefit corporation may also elect to pursue one or more specific public benefit purposes. Since the creation of specific public benefit is optional, paragraph (7) of this definition permits a benefit corporation to identify a specific public benefit that is different from those listed in paragraphs (1) through (6).

"Third-party standard." The requirement in section 401 that a benefit corporation prepare an annual benefit report that assesses its performance in creating general public benefit against a third-party standard provides an important protection against the abuse of benefit corporation status. The performance of a regular business corporation is measured by the financial statements that the corporation prepares. But the performance of a benefit corporation in creating general or specific public benefit will not be readily apparent from those financial statements. The annual benefit report is intended to permit an evaluation of that performance so that the shareholders can judge how the directors have discharged their responsibility to manage the corporation and thus whether they should be retained in office. The annual benefit report is also intended to reduce "greenwashing" (the phenomenon of businesses seeking the cachet of being more environmentally and socially responsible than they actually are) by giving consumers and the general public a means of judging whether a business is living up to its claimed status as a benefit corporation.

The financial support that must be disclosed by entity if it wishes to make available a third party standard should include investment income, grants, and other types of support in addition to revenue it receives from its operations.

§ 103. Incorporation of benefit corporation.

A benefit corporation shall be incorporated in accordance with [*cite incorporation provisions of the business corporation law*], but its articles of incorporation must also state that it is a benefit corporation.

Comment:

This section provides for how a corporation that is being newly formed may elect to be a benefit corporation. Existing corporations may become benefit corporations in the manner provided in section 104.

This chapter only applies to domestic business corporations. A foreign business corporation that has a status in its home jurisdiction similar to the status of a benefit corporation under this chapter is not subject to this chapter and has the status simply of a foreign business corporation for purposes of the state's business corporation law.

The term "benefit corporation" used in this section is defined in section 102.

§ 104. Election of benefit corporation status.

(a) Amendment. – An existing business corporation may become a benefit corporation under this [*chapter*] by amending its articles of incorporation so that they contain, in addition to the requirements of [*cite section of the business corporation law on the required contents of articles of incorporation*], a statement that the corporation is a benefit corporation. In order to be effective, the amendment must be adopted by at least the minimum status vote.

(b) Fundamental transactions. –

(1) This subsection applies if both of the following subparagraphs apply:

(i) An entity that is not a benefit corporation is[*:*

(A)] a party to a merger[*, consolidation, or conversion*]; or

[*(B) the exchanging entity in a share exchange*].

(ii) The surviving[*, new, or resulting*] entity in the merger, [*consolidation, conversion, or share exchange*] is to be a benefit corporation.

(2) In order to be effective, a plan of merger[*, consolidation, conversion, or share exchange*] subject to this subsection must be adopted by at least the minimum status vote.

<u>Comment</u>:

This section provides the procedures for an existing corporation to become a benefit corporation. A corporation that is being newly formed may become a benefit corporation in the manner provided in section 103. Subsection (a) applies to a business corporation that is directly electing to be a benefit corporation by amending its articles of incorporation. Subsection (b) applies when a corporation is becoming a benefit corporation indirectly in the context of a fundamental transaction. In both cases, the change to benefit corporation status must be approved by at least the minimum status vote.

Subsection (b) also applies to an entity that is not a corporation when the entity is a party to a transaction that will result in a benefit corporation. In those situations, a supermajority vote of the owners of the entity is required by subsection (b).

See section 201(d) with respect to changing the identification of a specific public benefit that it is the purpose of a benefit corporation to pursue.

The following terms used in this section are defined in section 102:

"benefit corporation"
"minimum status vote"

§ 105. Termination of benefit corporation status.

(a) Amendment. – A benefit corporation may terminate its status as such and cease to be subject to this [*chapter*] by amending its articles of incorporation to delete the provision required by section 103 or 104 to be stated in the articles of a benefit corporation. In order to be effective, the amendment must be adopted by at least the minimum status vote.

(b) Fundamental transactions. – If a plan of merger[*, consolidation, conversion, or share exchange*] would have the effect of terminating the status of a business corporation as a benefit corporation, the plan must be adopted by at least the minimum status vote in order to be effective. Any sale, lease, exchange, or other disposition of all or substantially all of the assets of a benefit corporation, unless the transaction is in the usual and regular course of business, shall not be effective unless the transaction is approved by at least the minimum status vote.

Comment:

This section provides the procedures for a benefit corporation to terminate voluntarily its status as a benefit corporation. As with an election of benefit corporation status under section 104, the termination may be accomplished either directly by an amendment of the articles or indirectly through a fundamental transaction.

The last sentence of subsection (b) provides a special rule for a sale of all or substantially all of the assets of a benefit corporation. Such a transaction will not result in a termination of the status of the corporation as a benefit corporation, but will have effectively the same result since it will terminate the operations of the business. Thus it was considered appropriate to require approval of a sale of assets by the minimum status vote. Whether a sale of assets is in the usual and regular course will be determined under the same standards as apply to that question under the state's business corporation law. *See, e.g.*, Model Business Corporation Act §§ 12.01 and 12.02.

The following terms used in this section are defined in section 102:

"benefit corporation"
"minimum status vote"

Subchapter 2

Corporate Purposes

Section
201. Corporate purposes.

§ 201. Corporate purposes.

(a) General public benefit purpose. – A benefit corporation shall have a purpose of creating general public benefit. This purpose is in addition to its purpose under [*cite section of the business corporation law on the purpose of business corporations*].

(b) Optional specific public benefit purpose. – The articles of incorporation of a benefit corporation may identify one or more specific public benefits that it is the purpose of the benefit corporation to create in addition to its purposes under [*cite section of the business corporation law on the purpose of business corporations*] and subsection (a). The identification of a specific public benefit under this subsection does not limit the purpose of a benefit corporation to create general public benefit under subsection (a).

(c) Effect of purposes. – The creation of general public benefit and specific public benefit under subsections (a) and (b) is in the best interests of the benefit corporation.

(d) Amendment. – A benefit corporation may amend its articles of incorporation to add, amend, or delete the identification of a specific public benefit that it is the purpose of the benefit corporation to create. In order to be effective, the amendment must be adopted by at least the minimum status vote.

(e) Professional corporations. – A professional corporation that is a benefit corporation does not violate [*cite section of professional corporation law, if any, that restricts the business in which a professional corporation may engage*] by having the purpose to create general public benefit or a specific public benefit.

<u>Comment</u>:

Every benefit corporation has the corporate purpose of creating general public benefit. A benefit corporation may also elect to pursue specific public benefits under subsection (b).

Subsection (c) confirms that pursuing general and specific public benefit is in the best interests of the benefit corporation. Because the basic duty of a director is to act in a manner that the director reasonably believes to be in the best interests of the corporation, decisions by the board of directors that promote the creation of general or specific public benefit will satisfy the requirement to act in the best interests of the corporation. If an ordinary business corporation includes in its articles of incorporation a statement of a specific purpose, it is by definition in the best interests of the corporation for the directors to pursue that purpose. Thus the rule in subsection (c) would be the case in any event, but has been stated expressly in subsection (c) because of the importance to the concept of a benefit corporation of the creation of public benefit.

Some professional corporation statutes provide that a professional corporation may not engage in any business other than rendering the professional service for which it was specifically incorporated. Subsection (e) makes clear that such a limitation will not interfere with a professional corporation electing to be a benefit corporation. In such a case, the professional corporation (such as a law firm, accounting firm, or medical practice) will be limited to providing the professional services for which it was incorporated, but it will be able to provide those services in a manner that creates general public benefit or a specific public benefit (for example, a medical practice that focuses on providing care for low-income individuals).

The following terms used in this section are defined in section 102:

"benefit corporation"
"general public benefit"
"minimum status vote"
"specific public benefit"

Subchapter 3
Accountability

Section

§ 301. Standard of conduct for directors.

(a) Consideration of interests. – In discharging the duties of their respective positions and in considering the best interests of the benefit corporation, the board of directors, committees of the board, and individual directors of a benefit corporation:

(1) shall consider the effects of any action or inaction upon:

(i) the shareholders of the benefit corporation;

(ii) the employees and work force of the benefit corporation, its subsidiaries, and its suppliers;

(iii) the interests of customers as beneficiaries of the general public benefit or specific public benefit purposes of the benefit corporation;

(iv) community and societal factors, including those of each community in which offices or facilities of the benefit corporation, its subsidiaries, or its suppliers are located;

(v) the local and global environment;

(vi) the short-term and long-term interests of the benefit corporation, including benefits that may accrue to the benefit corporation from its long-term plans and the possibility that these interests may be best served by the continued independence of the benefit corporation; and

(vii) the ability of the benefit corporation to accomplish its general public benefit purpose and any specific public benefit purpose; and

(2) may consider:

[*(i) the interests referred to in [cite constituencies provision of the business corporation law if it refers to constituencies not listed above]; and*

(ii)] other pertinent factors or the interests of any other group that they deem appropriate; but

(3) need not give priority to the interests of a particular person or group referred to in paragraph (1) or (2) over the interests of any other person or group unless the benefit corporation has stated in its articles of incorporation its intention to give priority to certain interests related to its accomplishment of its general public benefit purpose or of a specific public benefit purpose identified in its articles.

(b) Coordination with other provisions of law. –The consideration of interests and factors in the manner required by subsection (a)[*:*

(1)] does not constitute a violation of [*cite provision of the business corporation law on the duties of directors generally*] [*; and*

(2) is in addition to the ability of directors to consider interests and factors as provided in [cite constituencies provision of the business corporation law]].

(c) Exoneration from personal liability. – Except as provided in the [*articles of incorporation*] [*bylaws*], a director is not personally liable for monetary damages for:

(1) any action or inaction in the course of performing the duties of a director under subsection (a) if the director performed the duties of office in compliance with [*cite provision of the business corporation law on the duties of directors generally*] and this section; or

(2) failure of the benefit corporation to pursue or create general public benefit or specific public benefit.

(d) Limitation on standing. – A director does not have a duty to a person that is a beneficiary of the general public benefit purpose or a specific public benefit purpose of a benefit corporation arising from the status of the person as a beneficiary.

(e) Business judgments. – A director who makes a business judgment in good faith fulfills the duty under this section if the director:

(1) is not interested in the subject of the business judgment;

(2) is informed with respect to the subject of the business judgment to the extent the director reasonably believes to be appropriate under the circumstances; and

(3) rationally believes that the business judgment is in the best interests of the benefit corporation.

Comment:

This section is at the heart of what it means to be a benefit corporation. By requiring the consideration of interests of constituencies other than the shareholders, the section rejects the holdings in *Dodge v. Ford*, 170 N.W. 668 (Mich. 1919), and *eBay Domestic Holdings, Inc. v. Newmark*, 16 A.3d 1 (Del. Ch. 2010), that directors must maximize the financial value of a corporation.

In a state that has adopted a "constituency statute," directors are authorized to consider the interests of corporate constituencies other than the shareholders, but the directors are not *required* to do so. Subsection (a) makes it mandatory for the directors of a benefit corporation to consider the interests and factors that they would otherwise simply be permitted to consider in their discretion under the typical constituency statute.

Subsection (d) negates any enforceable duty of directors to non-shareholder constituents. *But see* section 305(b) which permits a benefit corporation to provide in its articles that an identified category of persons may bring a benefit enforcement proceeding. If a benefit corporation were to do so, the identified non-shareholder constituents would be able to allege a breach of duty by the directors under this chapter for failing to pursue or create general or specific public benefit, but subsection (d) would prevent those constituents from alleging a breach of duty to them.

Subsection (e) confirms that the business judgment rule applies to actions by directors under this section. The formulation of the rule is patterned after American Law Institute, Principles of Corporate Governance: Analysis and Recommendations § 4.01(c). If the law of the enacting state is not clear that the business judgment rule applies generally to actions by directors of corporations that are not business corporations, consideration should be given to confirming that the rule applies more broadly than just under this chapter. The best interests of the corporation referred to in subsection (e)(3) include the creation of general public benefit and specific public benefit under section 201(c) and the determination of what is in the best interests of the benefit corporation requires consideration of the interests and factors listed in subsection (a).

The following terms used in this section are defined in section 102:

"benefit corporation"
"general public benefit"
"specific public benefit"
"subsidiary"

§ 302. Benefit director.

(a) General rule. – The board of directors of a benefit corporation that is a publicly traded corporation shall, and the board of any other benefit corporation may, include a director, who:

(1) shall be designated the benefit director; and

(2) shall have, in addition to the powers, duties, rights, and immunities of the other directors of the benefit corporation, the powers, duties, rights, and immunities provided in this [*subchapter*].

(b) Election, removal, and qualifications. – The benefit director shall be elected, and may be removed, in the manner provided by [*cite provisions of the business corporation law on the election and removal of directors generally*]. [*Except as provided in subsections (f) and (g),*] the benefit director shall be an individual who is independent. The benefit director may serve as the benefit officer at the same time as serving as the benefit director. The articles of incorporation or bylaws of a benefit corporation may prescribe additional qualifications of the benefit director not inconsistent with this subsection.

(c) Annual compliance statement. – The benefit director shall prepare, and the benefit corporation shall include in the annual benefit report to shareholders required by section 401, the opinion of the benefit director on all of the following:

(1) Whether the benefit corporation acted in accordance with its general public benefit purpose and any specific public benefit purpose in all material respects during the period covered by the report.

(2) Whether the directors and officers complied with sections 301(a) and 303(a), respectively.

(3) If, in the opinion of the benefit director, the benefit corporation or its directors or officers failed to act or comply in the manner described in paragraphs (1) and (2), a description of the ways in which the benefit corporation or its directors or officers failed to act or comply.

(d) Status of actions. – The act or inaction of an individual in the capacity of a benefit director shall constitute for all purposes an act or inaction of that individual in the capacity of a director of the benefit corporation.

(e) Exoneration from personal liability. – Regardless of whether the articles of incorporation or bylaws of a benefit corporation include a provision eliminating or limiting the personal liability of directors authorized by [*cite section of the business corporation law permitting exoneration of directors*], a benefit director shall not be personally liable for an act or omission in the capacity of a benefit director unless the act or omission constitutes self-dealing, willful misconduct, or a knowing violation of law.

[***(f) Alternative governance arrangements.*** –

(1) The articles of incorporation or bylaws of a benefit corporation must provide that the persons or shareholders who perform the duties of the board of directors include a person with the powers, duties, rights and immunities of a benefit director if either of the following applies:

(i) The articles of incorporation or bylaws of the benefit corporation provide that the powers and duties conferred or imposed upon the board of directors shall be exercised or performed by a person other than the directors under [cite section, if any, of the business corporation law permitting alternative governance arrangements].

(ii) The articles of incorporation or bylaws of a statutory close corporation that is a benefit corporation provide that the business and affairs of the corporation shall be managed by or under the direction of the shareholders.

(2) A person that exercises one or more of the powers, duties or rights of a benefit director under this subsection:

(i) does not need to be independent of the benefit corporation;

(ii) shall have the immunities of a benefit director;

(iii) may share the powers, duties, and rights of a benefit director with one or more other persons; and

(iv) shall not be subject to the procedures for election or removal of directors in [cite applicable provisions of the business corporation law] unless:

(A) the person is also a director of the benefit corporation; or

(B) the articles or bylaws make those procedures applicable.]

[***(g) Professional Corporations****. – The benefit director of a professional corporation does not need to be independent.*]

<u>**Comment**</u>**:**

The statement of the benefit director required by subsection (c) is an important part of the transparency required under this chapter. The perspective of the benefit director on whether the corporation has been successful in pursuing its general and any named specific public benefit purpose will be an important source of information for the shareholders as to whether the directors have adequately discharged their stewardship of the benefit corporation and its resources.

Subsection (d) makes clear that the actions of a benefit director are actions of a director of the benefit corporation and are subject to the same standards as actions of directors generally.

The wording of subsection (e) should be conformed to the provision of the state's business corporation law that permits the shareholders to adopt a provision of the articles of incorporation or bylaws exonerating directors from liability for breach of duty. But unlike existing exoneration provisions, subsection (e) does not require the benefit corporation to adopt an implementing provision in the articles or bylaws. Instead the liability shield provided by subsection (e) automatically applies to all benefit directors.

Subsection (f) should be adopted in those states that authorize a business corporation to vary the usual functions of the board of directors, either in the general business corporation law or, more typically, a statutory close corporation statute. If a benefit corporation chooses to vary the usual governance paradigm under one of those sections, subsection (f) explains how this section will apply to the corporation. *See* section 401(a)(8) which requires a benefit corporation that has so varied its governance to describe the alternative arrangements in its annual benefit report.

The following terms used in this section are defined in section 102:

"benefit corporation"
"benefit director"
"benefit officer"
"general public benefit"
"independent"
"publicly traded corporation"
"specific public benefit"

§ 303. Standard of conduct for officers.

(a) General rule. – Each officer of a benefit corporation shall consider the interests and factors described in section 301(a) in the manner provided in that subsection if:

(1) the officer has discretion to act with respect to a matter; and

(2) it reasonably appears to the officer that the matter may have a material effect on the creation by the benefit corporation of general public benefit or a specific public benefit identified in the articles of incorporation of the benefit corporation.

(b) Coordination with other provisions of law. – The consideration of interests and factors in the manner described in subsection (a) shall not constitute a violation of [*cite provision of the business corporation law on the duties of officers*].

(c) Exoneration from personal liability. – Except as provided in the [*articles of incorporation*] [*bylaws*], an officer is not personally liable for monetary damages for:

(1) an action or inaction as an officer in the course of performing the duties of an officer under subsection (a) if the officer performed the duties of the position in compliance with [*cite provision of the business corporation law on the duties of officers*] and this section; or

(2) failure of the benefit corporation to pursue or create general public benefit or specific public benefit.

(d) Limitation on standing. – An officer does not have a duty to a person that is a beneficiary of the general public benefit purpose or a specific public benefit purpose of a benefit corporation arising from the status of the person as a beneficiary.

(e) Business judgments. – An officer who makes a business judgment in good faith fulfills the duty under this section if the officer:

(1) is not interested in the subject of the business judgment;

(2) is informed with respect to the subject of the business judgment to the extent the officer reasonably believes to be appropriate under the circumstances; and

(3) rationally believes that the business judgment is in the best interests of the benefit corporation.

Comment:

As an agent of the corporation, an officer is generally required to follow the instructions of his or her principal. But in those instances where an officer has discretion to act with a respect to a matter, subsection (a) requires the officer to consider the interests of the benefit corporation's constituencies in the same manner as required of the directors by section 301.

This section applies to all of the officers of the benefit corporation and is not limited just to the benefit officer, if any, of the benefit corporation.

Subsection (d) provides an exoneration from personal liability for officers similar to the exoneration provided for directors. If the law of the enacting state is not clear that officers can be exonerated in the same manner as directors, consideration should be given to confirming that officers of business corporations that are not benefit corporations may be exonerated. *See also* the Comment to section 301(d) with respect to subsection (d).

Subsection (e) confirms that the business judgment rule applies to actions by officers under this section. The formulation of the rule is patterned after American Law Institute, Principles of Corporate Governance: Analysis and Recommendations § 4.01(c). If the law of the enacting state is not clear that the business judgment rule applies generally to actions by officers of corporations that are not business corporations, consideration should be given to confirming that the rule applies more broadly than just under this chapter. The best interests of the corporation referred to in subsection (e)(3) include the creation of general public benefit and specific public benefit under section 201(c) and the determination of what is in the best interests of the benefit corporation requires consideration of the interests and factors listed in section 301(a).

The following terms used in this section are defined in section 102:

"benefit corporation"
"benefit officer"
"general public benefit"
"specific public benefit"

§ 304. Benefit officer.

(a) Designation. – A benefit corporation may have an officer designated the benefit officer.

(b) Functions. – A benefit officer shall have:

(1) the powers and duties relating to the purpose of the corporation to create general public benefit or specific public benefit provided:

(i) by the bylaws; or

(ii) absent controlling provisions in the bylaws, by resolutions or orders of the board of directors.

(2) the duty to prepare the benefit report required by section 401.

Comment:

The designation of a benefit officer is optional. But if a benefit officer is designated, one of the duties of that officer will be to prepare the annual benefit report required by section 401.

The following terms used in this section are defined in section 102:

"benefit corporation"
"benefit officer"
"general public benefit"
"specific public benefit"

§ 305. Right of action.

(a) Limitations. –

(1) Except in a benefit enforcement proceeding, no person may bring an action or assert a claim against a benefit corporation or its directors or officers with respect to:

(i) failure to pursue or create general public benefit or a specific public benefit set forth in its articles of incorporation; or

(ii) violation of an obligation, duty, or standard of conduct under this [*chapter*].

(2) A benefit corporation shall not be liable for monetary damages under this [*chapter*] for any failure of the benefit corporation to pursue or create general public benefit or a specific public benefit.

(b) Standing. – A benefit enforcement proceeding may be commenced or maintained only:

(1) directly by the benefit corporation; or

(2) derivatively [*in accordance with [cite sections of business corporation law on derivative suits]*] by:

(i) a person or group of persons that owned beneficially or of record at least 2% of the total number of shares of a class or series outstanding at the time of the act or omission complained of;

(ii) a director;

(iii) a person or group of persons that owned beneficially or of record 5% or more of the outstanding equity interests in an entity of which the benefit corporation is a subsidiary at the time of the act or omission complained of; or

(iv) other persons as specified in the articles of incorporation or bylaws of the benefit corporation.

(c) Beneficial ownership. – For purposes of this section, a person is the beneficial owner of shares or equity interests if the shares or equity interests are held in a voting trust or by a nominee on behalf of the beneficial owner.

Comment:

Standing in an action against the directors or officers of a business corporation that is not a benefit corporation for breach of duty is limited in most states just to the corporation or shareholders bringing a derivative suit. This section broadens the categories of persons that can bring a derivative suit to include directors, 5% owners of a parent entity, and other persons to which a benefit corporation grants standing in its articles of incorporation or bylaws. To reduce the possibility of nuisance suits, a shareholder or group of shareholders bringing a derivative suit must own at least 2% of the outstanding shares of the benefit corporation.

This section only applies to actions or claims arising under this chapter. Lawsuits for breaches of duty arising outside of this chapter, or for breach of contract by directors, officers, or the benefit corporation are not subject to this section.

The following terms used in this section are defined in section 102:

"benefit corporation"
"benefit enforcement proceeding"
"general public benefit"
"specific public benefit"
"subsidiary"

Subchapter 4
Transparency

Section
401. Preparation of annual benefit report.
402. Availability of annual benefit report.

§ 401. Preparation of annual benefit report.

(a) Contents. – A benefit corporation shall prepare an annual benefit report including all of the following:

(1) A narrative description of:

(i) The ways in which the benefit corporation pursued general public benefit during the year and the extent to which general public benefit was created.

(ii) Both:

(A) the ways in which the benefit corporation pursued a specific public benefit that the articles of incorporation state it is the purpose of the benefit corporation to create; and

(B) the extent to which that specific public benefit was created.

(iii) Any circumstances that have hindered the creation by the benefit corporation of general public benefit or specific public benefit.

(iv) The process and rationale for selecting or changing the third-party standard used to prepare the benefit report.

(2) An assessment of the overall social and environmental performance of the benefit corporation against a third-party standard:

(i) applied consistently with any application of that standard in prior benefit reports; or

(ii) accompanied by an explanation of the reasons for:

(A) any inconsistent application; or

(B) the change to that standard from the one used in the immediately prior report.

(3) The name of the benefit director and the benefit officer, if any, and the address to which correspondence to each of them may be directed.

(4) The compensation paid by the benefit corporation during the year to each director in the capacity of a director.

(5) The statement of the benefit director described in section 302(c).

(6) A statement of any connection between the organization that established the third-party standard, or its directors, officers or any holder of 5 percent or more of the governance interests in the organization, and the benefit corporation or its directors, officers or any holder of 5 percent or more of the outstanding shares of the benefit corporation, including any financial or governance relationship which might materially affect the credibility of the use of the third-party standard.

[*(7) If the benefit corporation has dispensed with, or restricted the discretion or powers of, the board of directors, a description of:*

(i) the persons that exercise the powers, duties, and rights and who have the immunities of the board of directors; and

(ii) the benefit director, as required by section 302(f).]

(b) Change of benefit director. – If, during the year covered by a benefit report, a benefit director resigned from or refused to stand for reelection to the position of benefit director, or was removed from the position of benefit director, and the benefit director furnished the benefit corporation with any written correspondence concerning the circumstances surrounding the resignation, refusal, or removal, the benefit report shall include that correspondence as an exhibit.

(c) Audit not required. – Neither the benefit report nor the assessment of the performance of the benefit corporation in the benefit report required by subsection (a)(2) needs to be audited or certified by a third party standards provider.

Comment:

A benefit corporation may change from year to year the standard it uses under subsection (a)(2) for assessing its performance. But if a benefit corporation uses the same standard for assessing its performance in more than one year, the standard must either be applied consistently or the benefit corporation must provide an explanation of the reasons for any inconsistent use of the standard.

Subsection (a)(5) requires the disclosure of all record shareholders that own 5% or more of the benefit corporation. The benefit corporation must also disclose in its annual benefit report any beneficial owners of 5% or more that are known to the benefit corporation, but it does not have an obligation to inquire as to the existence of any such owners.

Subsection (b) is patterned after Item 5.02(a)(2) of Form 8-K under the Securities Exchange Act of 1934.

The following terms used in this section are defined in section 102:

"benefit corporation"
"benefit director"
"general public benefit"
"specific public benefit"
"third-party standard"

§ 402. Availability of annual benefit report.

(a) Timing of report. – A benefit corporation shall send its annual benefit report to each shareholder:

(1) within 120 days following the end of the fiscal year of the benefit corporation; or

(2) at the same time that the benefit corporation delivers any other annual report to its shareholders.

(b) Internet website posting. – A benefit corporation shall post all of its benefit reports on the public portion of its Internet website, if any; but the compensation paid to directors and financial or proprietary information included in the benefit reports may be omitted from the benefit reports as posted.

(c) Availability of copies. – If a benefit corporation does not have an Internet website, the benefit corporation shall provide a copy of its most recent benefit report, without charge, to any person that requests a copy, but the compensation paid to directors and financial or proprietary information included in the benefit report may be omitted from the copy of the benefit report provided.

(d) Filing of report. –

(1) Concurrently with the delivery of the benefit report to shareholders under subsection (c), the benefit corporation shall deliver a copy of the benefit report to the [Secretary of State] for filing, but the compensation paid to directors and financial or proprietary information included in the benefit report may be omitted from the benefit report as delivered to the [Secretary of State].

(2) The [Secretary of State] shall charge a fee of $__ for filing a benefit report.

Comment:

Subsection (b) requires a benefit corporation to post all of its annual benefit reports on its website, but subsection (c) only requires that the most recent benefit report be supplied if the benefit corporation does not have a website.

The term "benefit corporation" used in this section is defined in section 102.

"benefit corporation"
"benefit director"

Appendix B

State by State Comparison of Benefit Corporation Legislation

See Attached.

Appendix C

Alternative Corporate Structures Intended to Address the Legal Issues Described Above

In recognition of the legal impediments described above, actors in the social enterprise community and their legal advisors have put forth a number of alternative legal structures with the ultimate goal of removing the legal jeopardy companies and their directors face when a for-profit entity pursues an objective or set of objectives other than solely maximizing shareholder value. The following discussion touches briefly on why not-for-profit organizations are subject to limitations as the appropriate vehicles for social entrepreneurs, and then summarizes the main alternative corporate entities being discussed in various states.

I. Not for Profits

One of the greatest challenges of conducting public benefit activities within a nonprofit legal entity is that they are usually organized for charitable purposes, which are very limited. Many environmental and social objectives fall outside of the narrow state and federal definitions of charitable purposes, so these broader considerations cannot be effectively advanced through nonprofit organizations. In situations where overlap does exist, nonprofits are hindered by their inability to raise investment/equity capital (because nonprofits cannot distribute profits to their owners and so as a practical matter cannot raise equity capital). Debt financing is sometimes available for nonprofits, but it is much more limited and expensive than in the for-profit context because the nonprofit's ability to repay the loan is constrained by its lack of access to equity. Put simply, many nonprofits face a daily battle for survival and sustainability and spend a significant amount of time and resources seeking contributions from foundations, governments and the public, all of which grow increasingly scarce in challenging economic conditions, such as those we face today.

While there are cases of nonprofit "hybrid" entities which provide a viable legal infrastructure for organizations conducting both tax-exempt and nonexempt activities, hybrid nonprofit legal infrastructures often involve complex organizational and operational structures that are typically expensive to construct and maintain and may also not be legally secure.[82] Tax-exempt organizations are also subject to extensive annual IRS reporting and regulatory scrutiny.

Not-for-profit organizations are also limited in their ability to hire and retain talented executives and employees because, although they are legally allowed to pay "reasonable" compensation to their employees, nonprofits usually pay less than the for-profit market rate for a given position in order to ensure that their decision to pay the rate will not come into question as "excessive compensation." Nonprofits often legitimize the lower pay rate on the ground that their employees are more fulfilled by their contribution to the charitable purpose of the

[82] *See* Allen R. Bromberger, *A New Type of Hybrid*, STANFORD SOC. INNOVATION REV., 52-53 (Spring 2011) (discussing legal issues facing social enterprises structured as hybrid nonprofit/for-profit entities, such as complying with IRS joint venture rules, private benefit concerns, unrelated business income tax, conflicts of interest, related party transactions, and IRS Form 990 disclosures).

organization, but in reality, nonprofit staff are almost always overworked because funding sources are constantly threatening to cut back or completely stop funding programs altogether.[83]

II. The L3C (and LLCs)

The L3C (short for low-profit limited liability company) is similar to a regular LLC (limited liability company) as an organizational form in which to conduct business in that it provides significant flexibility in structuring governance provisions, provides legal protection to owners and managers, and can attract private capital investment (including equity capital). However, unlike a corporation or most traditional LLCs, an L3C expressly recognizes that its social mission takes priority over its profit objective.[84] Currently eight U.S. states have passed L3C legislation.[85] L3Cs are variants of the traditional LLC form, and are incorporated into the preexisting LLC statutory framework. Thus, they are subject to the same general governance properties provided by the traditional LLC statute of the state.

(A) Program-Related Investments

The L3C was essentially designed to facilitate "program-related investments" (or "PRIs") by charitable foundations in a for-profit entity. Program-related investments are investments made by foundations to support charitable activities that involve the potential return of capital within an established time frame.[86] Tax-exempt section 501(c)(3) private foundations are required to distribute 5% of their income each year for charitable purposes, either in the form of grants or investments. If they choose to invest the money, any investment must qualify as a PRI, which as defined by sections 4944(c) and 170(c)(2)(B) of the Internal Revenue Code are those investments with primarily religious, charitable, scientific, literary, or educational purposes. Also, the PRI must not have a significant investment purpose and must not be used to fund political activity. Private foundations that fail to meet those requirements could be subject to significant tax penalties and may risk losing their exempt status; as a result of these risks, PRIs have traditionally been made only in IRS-recognized not-for-profit entities.

There are a number of issues associated with the use of an L3C to attract PRIs. The IRS has not approved L3Cs as a target entity for program related investments. While L3C proponents maintain that the L3C statutory language is uniquely adapted to the IRS's program related

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[83] Not-for-profit entities are subject to federal tax laws and regulations. Among other things, federal tax law (i) precludes not-for-profit entities from distributing any profits, thus making it difficult for nonprofits to attract capital; (ii) limits financial remuneration of employees, thus making it difficult for nonprofits to attract and retain talent; and (iii) limits the revenue-generating activities of such entities which would in the private sector ordinarily accompany sustainably operating and expanding like a successful business.

[84] *See* VT. STAT. ANN. tit. 11 § 3001(27)(B) (2011) (requiring that "[n]o significant purpose of the company is the production of income or the appreciation of property"); 805 ILL. COMP. STAT. 180/1-5 (2011) (same); WYO. STAT. ANN. § 17-15-102(a)(ix)(B) (2011) (same).

[85] 805 ILL. COMP. STAT. § 180/1-26; LA. REV. STAT. ANN. § 12:1302 (2011); ME. REV. STAT. ANN. tit. 9, § 1611 (2011); MICH. COMP. LAWS § 450.4101 (2011); N.C. GEN. STAT. § 57C-2-01 (2011); UTAH CODE ANN. § 48-2c-412 (West 2011); VT. STAT. ANN. tit. 11 § 3001(27); WYO. STAT. ANN. § 17-15-102(a)(ix).

[86] PRIs are attractive to recipients because they generally represent a lower cost of capital than a market-rate investment. To the foundation investor, PRIs are attractive (as an alternative to outright grants) because they allow for the potential for return of capital (with investment return) that can then be used for another purpose later.

investment regulations,[87] numerous authorities recognize that the L3C language – while mimicking the IRS program related investment regulations – neither binds the IRS to approve program related investments in L3Cs, nor gives any indication that the IRS is likely to approve investments in L3Cs over investments in any other legal entity. This poses a significant risk to foundations who might consider investing in an L3C as somehow "pre-approved" by the IRS as a PRI since the IRS determination as to whether an investment qualifies as a PRI is a transaction-specific one.

(B) Other Issues Concerning L3Cs and LLCs

L3Cs can also be expected to have substantial difficulty attracting market-rate investments because of the L3C moniker ("low-profit") and statutory language limiting income production. Although most statutes carve out an opportunity for incidental financial success,[88] investors seeking market-rate returns do not typically invest in companies that *might* only *incidentally* provide them with such a return – they do not invest in companies that do not seek to produce the income from which the company may provide them the market-rate return that is the goal and purpose of the investment.

It is also the case that many investors have a policy, or at least a strong preference, for investing in a corporation rather than an LLC. While some LLC's have gone public, LLCs still represent a small minority of IPOs over the last decade,[89] and there remains material resistance among venture firms to investing in LLCs. Below are some of the reasons given for this, followed by some reasons why resistance ought to be less to investing in a new corporate form:

- Venture firms are more comfortable with C corporation structures. They have all the form documents, feel they understand the legal precedents with conflicts, and do not typically care about pass-through treatment of profits since venture-funded companies don't often generate profits due to the early stage of investment.

- There is minimal case history about LLC liability issues (e.g., piercing the corporate veil) and Investment Company Act/corporate control issues for venture firms to rely on even if they are willing to think outside the typical C corporation box.

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[87] PRI categorization requires that: (1) the *primary purpose* of the investment is to accomplish a charitable or educational purpose; (2) *no significant purpose* is the production of income or asset appreciation; and (3) no purpose is to promote a prohibited political or legislative purpose. I.R.C. § 4944 (2006); Treas. Reg. § 53.4944-3(a)(1)(i)-(iii), (a)(2)(iv) (1972); *see also* Carter G. Bishop, *The Low-Profit LLC (L3C): Program Related Investment by Proxy or Perversion?*, 63 ARK. L. REV. 243, 249 (2010) (discussing PRI requirements). L3C statutory requirements in Vermont pose three analogous requirements: (a) the LLC *significantly furthers* the accomplishment of one or more charitable or educational purposes *and would not have been formed but for* its relationship to the accomplishment of such purposes, (b) *no significant purpose* of the LLC is income production or capital appreciation, and (c) no purpose of the LLC is to accomplish political or legislative purposes. VT. STAT. ANN. tit. 11, § 21:3001(27).

[88] *See*, *e.g.*, VT. STAT. ANN. tit. 11, § 21:3001(27)(B) ("[H]owever, [ ] the fact that a person produces significant income or capital appreciation shall not, in the absence of other factors, be conclusive evidence of a significant purpose involving the production of income or the appreciation of property.").

[89] Practical Law Company, *Preparing a Company for an Initial Public Offering*, available at www.practicallaw.com (last visited September 27, 2011).

- LLCs are governed almost entirely by the terms of the LLC Operating Agreement (a contract), which differ significantly from one LLC to the next, whereas corporations are governed largely by corporate law statutes and relatively standard-form constituent documents (articles/by-laws).

- For private equity investors (and even more so for public market investors), the lack of formulaic content in a LLC agreement means too much work and too much risk, and therefore many have policies against making these investments.

Below are several reasons a new corporate form ought not meet similar objections:

- A new corporate form is a corporation governed predominantly by corporate law, not by contract law, so most of the (more extensive) body of corporate legal precedent will apply.

- The governing documents of a new corporate form will typically be more uniform than those of an LLC, making due diligence easier for investors.

There is at least one important additional reason why a new corporate form would be a better solution to provide the clear safe harbor desired by social entrepreneurs and investors. The law of fiduciary duties (which can theoretically be contracted away in the operating agreement of an LLC) are the product of case law in many states (including Delaware) and it is unclear whether efforts to provide managing members with protection from suit when pursuing a trade-off between increasing financing value in favor of increasing social impact would be upheld by the courts. The advantage of a statutory safe-harbor like the one created by benefit corporation legislation is that the courts must abide by the statutory framework.[90]

In addition to these investor issues, because of L3Cs' inability to pursue production of income as a significant purpose of their activities, L3Cs may experience many of the same difficulties in hiring effective talent as do nonprofits.

Many commentators have also argued that the L3C as a separate legal entity is unnecessary, since any of the L3C's statutorily-mandated provisions could always be adopted into the traditional LLC form by way of the LLC's operating agreement.[91] As a matter of transparency and accountability, L3Cs have no third-party evaluator to determine whether or not they are pursuing their charitable purpose and/or achieving a measurable social impact. Unlike nonprofits which must comply with annual reporting requirements imposed by the IRS in exchange for exempt status, and benefit corporations as discussed above, L3Cs are free to self-regulate their charitable purpose and the extent to which they report publicly on their activities.

III. <u>The Flexible Purpose Corporation (FPC)</u>

[90] Additionally, L3C statutes do not address the scope of directors' duties, stating simply that an L3C's operating agreement may not "eliminate or reduce a member's fiduciary duties" (though it may define what is or is not a breach of such duties). *See* 805 ILL. COMP. STAT. 180/15-5 (listing requirements for LLC operating agreements).
[91] *See*, *e.g.*, Bishop, *supra* note 25, at 249 (stating L3C statutory provisions provide no advantage, apart from branding, that could not otherwise be achieved via contract or operating agreement).

Legislation to create the "Flexible Purpose Corporation" ("FPC") as a new type of corporate entity has been enacted only in California.[92] FPCs are a variation of California corporation and, as such, the full range of equity and debt private options are available to capitalize such an entity. As with the benefit corporation, financial profitability as an objective need not be subordinated to the entity's public purpose.

(A) Drafting Approach

According to its principal author, FPC legislation was drafted primarily to meet the needs of larger, often publicly-traded companies interested in possessing a safe harbor to pursue at least one "special purpose" beyond the maximization of shareholder value.[93] It was drafted recognizing the significant constraints publicly-traded companies would face in adopting a new corporate form.[94] As a result, and as described below, FPC legislation does not meet the needs of most of the consumers, investors, and entrepreneurs described in Section I.

Before discussing why the flexible purpose corporation does not meet the needs of the consumers, investors, and entrepreneurs described in Section I, there is an additional issue with the approach taken in drafting FPC legislation.

Unlike benefit corporation statutes which have been drafted so that the existing corporation code applies to benefit corporations in every respect except those explicitly stipulated in the benefit corporation legislation, FPC legislation adds an entirely new Division and two new Sections, as well as amends 12 Sections of the California corporate law code.[95] The drafting approach results in legislation that is 86 pages in length, making it more cumbersome for attorneys to reference than the typically 13 page benefit corporation statutes.

More importantly, this drafting approach creates potential legal and administrative issues in keeping the FPC in conformity to the corporation code as changes to the code occur over time. Any change to the California corporate code would require a corresponding change to the flexible purpose code. In addition to the potential risk of non-conformity, this approach also likely creates additional administrative burden and expense for the state in monitoring and maintaining conformity over time. It is also not clear to what extent existing California corporate case law and authority would apply to FPCs.

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[92] FPCs would be organized pursuant to the California Corporate Flexibility Act of 2011, which was signed into law on October 9, 2011 and becomes effective on [_____]. *See generally* California Corporate Flexibility Act (Cal. 2011).

[93] W. Derrick Britt, R. Todd Johnson and Susan H. MacCormac, *FAQ, Proposed Amendments to the California Corporations Code for a New Corporate Form: The Flexible Purpose Corporation and Senate Bill 201* (February 23, 2011), *available at* http://www.thecorporatecounsel.net/member/FAQ/Flexible/02_11_FAQ.pdf.

[94] *See* Joel Makower, *California's Bold Move to Legitimize Sustainable Business*, GREENBIZ.COM (Feb. 14, 2011), http://www.greenbiz.com/blog/2011/02/14/california%E2%80%99s-move-legalize-sustainable-business (stating large California corporations face significant risks if they "embed" social or environmental criteria into their articles of incorporation).

[95] S.B. 201, 2011-2012 Leg., Reg. Sess. (Cal. 2011). "An act to amend Sections 102, 107, 158, 201, 1100, 1113, 1152, 1155, 1201, 5122, 7122, and 9122 of, to add Sections 171.08 and 1112.5 to, and to add Division 1.5 (commencing with Section 2500) to Title 1 of, the Corporations Code, relating to corporations."

(B) "Special Purpose"

To become an FPC, a company's articles of incorporation need to specify at least one "special purpose" that the corporation will pursue, which can include (but is not limited to) charitable or public benefit activities. The directors and officers of the FPC would effectively enjoy a safe harbor in pursuit of any such "special purpose." However, while a "special purpose" could be defined broadly (e.g., as broadly as corporate purpose is defined in benefit corporation legislation; namely, "to create material positive impact on society and the environment"), that "special purpose" can also be defined narrowly, and be limited in duration.

While this may accomplish the more narrow legal objective of the executives, directors, and investors of an FPC, from the point of view of the consumers, investors, and entrepreneurs described in Section II, such an FPC would receive the unintended halo effect of being recognized by the state as a "new kind of company" simply by pursuing the most modest and short-term socially or environmentally responsible activity – potentially even something it already does, like buying enough carbon offsets to be "carbon neutral" this year, or building a playground.

In addition to the above consumer and investor protection issues, creating a new corporate form for companies making such potentially limited commitments, creates significant risk from the perspective of policy makers. For example, a hypothetical FPC oil company could declare its "special purpose" to support renewable energy projects making up less than 5% of its revenues while being cited by regulators for hundreds of violations in its core oil business, all the while marketing itself as a "new kind of company" with the imprimatur of the state.

Another example demonstrates a technical challenge for policy makers in the FPC approach to corporate purpose. A hypothetical FPC could declare, achieve, and report on its "special purpose" to be "carbon neutral" this year. What happens next year? Should this FPC receive the long-term, indeed perpetual, benefits of state recognition as a "new kind of company" while only achieving a short-term "special purpose"? While FPC legislation does require disclosure that the company has achieved its limited "special purpose", this does not solve the problem created for consumers and investors who may have supported or invested in the company because of its FPC status and the distinction that such a state recognized corporate form implies.

Another challenge in the FPC approach to corporate purpose is the lack of flexibility it affords entrepreneurs. Entrepreneurs are forced to declare one or more "special purposes" at the time of incorporation or election of FPC status. This forces entrepreneurs to do one of two things: either 1) declare a broad "special purpose" that gives them flexibility to adapt, innovate, and respond to changes in the market or to evolved understanding of how to achieve most effectively their social or environmental goals; or 2) declare a narrow "special purpose" that might then limit their flexibility, and perhaps even create additional legal exposure, to pursue other later-identified or simply undeclared beneficial activities without the additional administrative burden of declaring another "special purpose."

The narrow "special purpose" approach also fails to recognize that most of the entrepreneurs, investors, and consumers described in Section I understand that their public benefit objectives, and thus their public benefit activities, are not narrow, but indeed broad, and often inter-related. Entrepreneurs, investors, and consumers that care about the environment, most often also care about how workers are treated, vice versa and etcetera.

Lastly, large public companies already pursue a wide variety of specific "CSR" (Corporate Social Responsibility) activities and need no new corporate form to do so. The safe harbor created by FPC legislation would indeed give directors of these large public corporations the additional legal protection to pursue named "special purposes" even in a defensive or other Revlon scenario, but it seems unlikely that a large public company would be in a position to need this safe harbor given the likely narrow impact of its "special purpose" activities relative to its overall financial performance. The vast majority of companies pursuing more comprehensive mission-driven business models or sustainability activities that have expressed a need for a legal protection, particularly in defensive and Revlon scenarios, support the alternative approach of benefit corporation legislation.

(C) Transparency and Accountability

As discussed above, there are two basic ways to create legal (as opposed to market-based) discipline to keep an organization accountable to its stated purposes: first, through transparent, credible, third-party reporting requirements; and second, through empowering stockholders to pursue causes of action against the corporation and its directors when corporate interests and purposes are not pursued.

As regards the first, the FPC statute's § 3500(a) provides that an FPC board of directors must provide an annual report to shareholders and publish it publicly on the internet,[96] and §3500(b) further provides that the annual report must contain a section providing "a management discussion and analysis (special purpose MD&A) concerning the flexible purpose corporation's stated purpose or purposes in its articles."[97] This means that the hypothetical FPC oil company mentioned above would be required only to report on its efforts to support renewable energy projects, which comprise less than 5% of its overall revenues, while not reporting on the fact that they were cited by regulators for scores of violations that year in its core oil business.

While this is an extreme example, it is true that no company does everything well as it relates to social and environmental performance (its treatment of its workforce, suppliers, consumers, community, and the environment) and as a result, the FPC reporting requirement seems insufficient to give the consumers and investors mentioned in Section I the information they need to make more informed decisions.

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[96] *See* California Corporate Flexibility Act of 2011, § 3500(a), S.B. 201, 2011-2012 Leg., Reg. Sess. (Cal. 2011) ("The board of a flexible purpose corporation shall cause an annual report to be sent to the shareholders not later than 120 days after the close of the fiscal year [and] . . . shall cause [the annual report] to be made publicly available by posting it on the flexible purpose corporation's Internet Web site or providing it through similar electronic means.")

[97] *Id.* § 3500(b); *see also id.* ("The special purpose MD&A shall include the information specified in this subdivision and any other information that the flexible purpose corporation's officers and directors believe to be reasonably necessary or appropriate to an understanding of the flexible purpose corporation's efforts in connection with its special purpose or purposes.")

The last point about third-party standards is critical. Unlike benefit corporation legislation, FPC legislation does not require the application of any independent third-party standard based upon which such a report is required to be made, leaving it to each individual flexible purpose corporation to report on its "special purpose" activities and their impacts as it sees fit. Proposed FPC legislation thus exacerbates the current lack of clarity about the social and environmental performance of companies by encouraging a proliferation of one-off, non-comparable, narrowly-tailored, self-reporting. This goes against the current trend, particularly in the public capital markets and among policy makers and large public corporations serious about sustainability, to encourage integrated sustainability reporting using credible third-party standards. As noted above in Section I.C, according to Institutional Shareholder Services, the largest shareholder proxy organization in the world, this trend is also true for institutional investors who "appear to be increasingly incorporating social and environmental considerations into their proxy voting decisions, as demonstrated by voting trends and institutional investor initiatives.[98]

As regards the second accountability mechanism (a right of action based upon failure to pursue the public purpose), the FPC statute does not create a procedure through which directors and officers can be held accountable, other than that which already exists for traditional corporations (namely the right to vote directors off the board). Shareholders of FPCs do not have a right of action for failure to pursue the FPC's "special purpose." This likely stems from the fact that FPC directors and officers would not be required by statute to pursue the "special purpose," but would simply be permitted to do so.

The FPC's expansion of a safe harbor for directors without a corresponding expansion of accountability could exacerbate director entrenchment, particularly in private companies. For example, directors could successfully attract private equity investors by declaring a broad "special purpose," report that they have done little toward achieving that purpose, and be comfortable that these minority shareholders have no legal recourse.

Perhaps most importantly, the FPC does not meet the needs of most of the entrepreneurs advocating for a new corporate form. These needs include market differentiation and mission protection. The challenge of market differentiation of FPCs is clear from the above examples regarding the potential existence of "bad actors" among the population of FPCs and how their potential existence would make becoming an FPC less desirable among leading sustainable businesses. The challenge of mission protection is an important one to these entrepreneurs. The entrepreneurs building mission-driven businesses want to maintain their mission as they bring in outside capital to grow. They fear losing control of their mission when they lose financial control and would benefit from the expanded right of action offered in benefit corporation legislation. Unlike benefit corporation legislation, FPC legislation does not offer these entrepreneurs the accountability tools they need to ensure that their businesses have the opportunity to grow in impact as they grow in size.

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[98] Carolyn Mathiasen & Erik Mell, Institutional Shareholder Serv., *Corporate Social Issues: A 2011 Proxy Season Preview: United States* 1 (2011).

The FPC has particular limitations: (i) because of its narrow approach, the FPC does not address the fundamentally broad concerns on the minds of the consumers, investors, and entrepreneurs described in Section I; (ii) because of its lack of accountability, the FPC does not address the fundamental legal issues important to both entrepreneurs and investors regarding the expansion of directors' fiduciary duties described in Section II; and (iii) because of its limited transparency mechanisms, the FPC could lead to abuse and additional market confusion, ultimately undermining efforts to serve the needs of the consumers, investors, and policy makers most interested in using the power of business to solve social and environmental problems by creating a clear, distinct marketplace of corporations meeting higher standards of corporate purpose, accountability, and transparency.

Colorado in the forefront in transforming the workplace

Updated: 06/02/2014 07:56:59 PM MDT

DenverPost.com

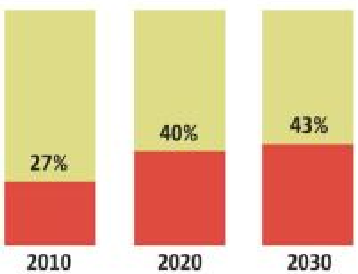
With a wave of millennials soon to enter the workforce, leaders in Colorado — from politicians to cutting-edge recruiters — are making changes they hope will maximize the state's competitive advantage in recruiting the best and brightest.

In just six years, millennials will account for about 40 percent of Colorado's workforce, and experts say they will make their presence known.

"We're looking at a baby boomer exodus. Every sector is facing the reality of potentially facing a worker shortage in the next 10 to 25 years," said Seana Steffen, founder and executive director of the Restorative Leadership Institute in Longmont. "In nonprofit and the private sector, there is a lot of concern about competing for the greatest talent, and that reality means these young people are actually going to have influence."

Millennials in the workplace

Millennials, those born in 1980 and later, are an increasing segment of Colorado's workforce.



Source: State Demographer *The Denver Post*

Studies show the millennial generation, born after 1980, is politically active and socially minded, especially when it comes to their vision of what business can achieve.

"I see a lot of talented people my age who have a choice where they can work," said Steven Winter, 25, who works for Blue Dot Advocates, a Boulder law firm that helps entrepreneurial companies tackle challenges like poverty and climate change. "Given two companies that are otherwise the same, they almost always go with the company that is doing something meaningful."

For businesses that want to make it clear their agenda is more than making a buck, Colorado now allows public benefit corporations, which have legal protection from shareholders when a social responsibility agenda is pursued, not just profits.

Twenty six states passed such laws in recent years, and 18 more states are working toward it. In the first month, 24 companies signed up under Colorado's new law.

This new terrain in Colorado does have some confusing terminology. Becoming a public benefit corporation is a legal status conferred by the state. Becoming a B Corporation — or B Corp — means the company is certified by the nonprofit B Lab that it meets high levels of social and environmental performance, transparency and accountability.

Rob Archuleta, founder of Pueblo-based Addict to Athlete, which helps people get sober through athletics, registered his company under the state law on the first day. "We want to benefit the public but we also want to be a legitimate business, not a nonprofit," he said. "This is a great way for us to break the mold ... showing that you don't have to be afraid to make a profit just because you're saving lives."

Also this year, B Lab opened B Lab Colorado in Boulder with the goal of quickly growing the movement in the state. B Lab, which provides independent certification of social and ethical responsibility, was co-founded by Boulder native Andrew Kassoy, who spent 16 years in the private equity business. So far, more than 1,000 companies in 33 countries have become B Corps, including Patagonia and Ben & Jerry's. In Colorado, they include New Belgium Brewing, Rally Software, GoLite and Namaste Solar.

In the last quarter, Rally Software of Boulder hired about 30 engineers, many of them millennials.

"Millennials are attracted to a cool culture that embraces a lot of their values, and one of those is aligned with our Rally for Impact program," said Rally Software human resources executive Liz Andora about the program that mobilizes citizen engineers to help solve the world's pressing problems.

Door to Door Organics of Louisville, another B Corp, is also seeing a competitive advantage. "Absolutely we're seeing a trend, that more and more millennials are coming our way because of our (social) mission," said the company's marketing manager, Carole Martell.

And David Lashen, who recently graduated from the University of Denver's Daniels College of Business with an MBA specializing in sustainable business strategy, chose to intern at the Restorative Leadership Institute, a B Corp, "because it has this really great business model centered on sustainable business," he said.

To help find employees for all these businesses, Nathaniel Koloc, 27, co-founded ReWork, a B Corp in Boulder that recruits workers for organizations focused on making social, environmental and cultural progress.

"About 60 percent of people in our talent pool are millennials," he said. "The new truth about millennials is that they care about meaningful work. This almost defines millennials more than technology, or being on the phone all the time. They want to be integrated human beings."

Not everyone excited about this burgeoning movement is a public benefit corporation or B Corp.

At JVA Consulting in Denver, Sarah Hidey last year launched the Social Enterprise Academy, which helps entrepreneurs and community leaders develop social ventures. At the most recent session, more than half the participants were millennials.

"Especially in Colorado, there is such a movement in the startup sector to not just start a company because it is profitable, but to address a social or environmental issue as well," she said.

A hub of B Corps and public benefit corporations can give Colorado an advantage in recruiting both talent and investors, said Kim Coupounas, a co-founder of the Boulder outdoor-gear company GoLite, who heads B Lab Colorado.

"The confluence of all these interests and parties (can) create a dramatic cultural shift in Colorado that makes it a beacon for other states," she said. "It's uniquely positioned to create something truly dramatic in the next 25 years."

Colleen O'Connor: 303-954-1083, coconnor@denverpost.com or twitter.com/coconnordp theguardian

Will Unilever become the world's largest publicly traded B corp?

After Natura was certified as the first publicly listed B Corp in December, Unilever CEO Paul Polman says his company is considering pursuing the status

Jo Confino in Davos

Friday 23 January 2015 10.34 EST

The movement to put purpose at the heart of business strategy has received a major boost with news that several multinationals, including consumer goods giant Unilever, are considering becoming B Corps, for-profit corporate entities that commit to positive social and environmental goals.

Last month, Brazil's top cosmetics, fragrance and toiletries maker, Natura, became the largest - and first publicly traded - company to attain B Corp sustainability certification. B Corps are certified by NGO B Labs as contributing social and environmental benefits beyond the financial bottom line.

Consumer goods giant Unilever could be the next one. The company's chief executive Paul Polman told Guardian Sustainable Business in Davos that becoming a B Corp would send a powerful signal that the purpose of business is not just profit, but to have a positive impact on society and the environment.

The complexity of operating in scores of countries, however, would make B Corp's certification process extremely complex for a company such as Unilever, and becoming a B Corp would take considerable time.

Jay Coen Gilbert, co-founder of B Lab, the non-profit company that began the B Corp movement, said the lack of resistance from Natura's institutional investors was a major breakthrough.

"The investors found it a non-issue as it was not a material change from how Natura was already operating," he said. "With some of that spade work being done by a pioneer, it now makes it easier for the next publicly traded companies ... we are in conversation with a number of larger multinationals to go through the assessment tool, and they are pretty interested in becoming officially certified.

"Having a larger group of globally influential companies join gives more credibility and draws other companies in. Some technology companies [that are] interested may not be so large in revenues but have huge reach."

Another boost to B Corp came when the similarly named B Team, the nonprofit organisation co-founded by Sir Richard Branson and Jochen Zeitz, said it would encourage its members to consider taking part in the certification.

Rajiv Joshi, managing director of the B Team, which includes Natura and Unilever amongst its members, said they want more large businesses to become certified B Corps and to support the creation of legal structures around the world that would allow businesses to put purpose at the heart of their business strategies.

Jostein Solheim, chief executive of Ben & Jerry's, has been leading negotiations with B Corp on behalf of Unilever, having become a B Corp three years ago. He said: "They are rapidly scaling up the movement and finding ways to apply their assessment in a time-efficient way to big companies like Natura.

"With the Unilever Sustainable Living Plan and Paul's strong leadership within the sustainable business movement we have been interested in assessing how to apply the B Lab assessment to a company of Unilever's scale. At the first stage we would be looking to assess how the certification could be applied to Unilever and the cost and complexity of getting it done. Paul [Polman] is very supportive of B&J's B Corp participation and the way we are leveraging a common standard to grow the overall movement and develop our values-led supplier network."

Natura's co-chair, Guilherme Leal, has been in Davos encouraging other publicly listed companies to become B Corps. He said he went through the assessment because, like Polman, he wants to help the movement to grow."We are trying to demonstrate that it's possible for larger corporations to become B Corps, even if the main target is the new generation of companies that are being created.

"I agree with Paul Polman that, for companies like Unilever working in many different countries, it's not an easy process, but I believe in collective learning and I think that the B Lab and big companies such as Unilever could learn together, trying to go through the process. We know that those companies will face some difficulties to manage different situations around the globe, but we need to reduce the differences amongst operations in different countries."

Leal says that Natura scored 111 out of a possible 200 in its initial B Corp assessment. "This is higher than the average, but as you can see we have 90 points to go, so this creates a roadmap to show where we should put higher efforts to become better and how to deal with some issues that we are not giving enough attention to. Understanding our fragilities better means we can see where we can improve."

Gilbert of B Lab says some publicly listed companies will end up just using the free assessment tool to benchmark their performance rather than go through the certification process. Around 1,200 companies are now B Corps and another 25,000 companies use its assessment tool, but with millions of businesses operating around the world, Gilbert says they are so far just scratching the surface.

This article was amended 26 January to clarify the definition of a B Corp.

This Davos coverage is funded by The B Team. All content is editorially independent except for pieces labelled "brought to you by". Find out more here.

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IMPACT INVESTING

How Etsy's IPO Could Spark Investor Interest in B Corps

Image credit: Etsy

Dennis Price

Social Impact Strategist, Contributing Writer At ImpactAlpha.com

MARCH 10, 2015

The planned initial public offering of shares in Etsy, the online handicrafts marketplace, will set up an intriguing test of mainstream investor appetite for companies that voluntarily submit their social and environmental performance to scrutiny in order to become certified “B Corps.”

It also will shine a light on new state legal structures intended to enshrine social purpose in a company's charter.

Brooklyn-based Etsy filed paperwork with the SEC to sell shares to the public in an IPO that would allow Etsy to raise up to $100 million. Though not yet profitable, Etsy generated nearly $200 million in revenue in 2014, facilitating $1.93 billion in transactions between 1.4 million sellers and 19.8 million buyers. Its shares would trade on NASDAQ under the ticker symbol ETSY.

Related: Why Bill Gates Is Backing Impact Entrepreneurs in India

Etsy's IPO would be the second among the more than 1,200 B Corps -- for-profit businesses that voluntarily meet higher standards of social and environmental performance and that are certified by the non-profit B Lab.

"Fundamentally, we believe that companies can and should use the power of business to create social good, which is reflected in our status as a Certified B Corporation," Etsy CEO Chad Dickerson wrote in a letter included with the filing. "Our commitment to using business as a force of good manifests itself in the way we run our business."

Denver-based Rally Software was the first B Corp to IPO in 2013. Natura, Brazil's largest cosmetics company, obtained a B Corp certification post-IPO on the Brazil Stock Exchange. Other notable B Corps include Warby Parker, Patagonia and Ben and Jerry's.

Although Etsy's B Corp assessment score in 2013 was well above the B Corp median, losing its B Corp certification, or a declining score on the publicly available B Corp assessment is a risk that could harm its reputation, Etsy says in the filing.

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That sets up the test. When Etsy obtained its certification, Delaware (the state in which Etsy is incorporated) had not yet adopted its statute enabling the creation of public benefit corporations. That legal structure, versions of which have been adopted in nearly two-dozen other states as well, expands a company's fiduciary responsibility to allow it to take into consideration interests of the community, employees and other stakeholders in addition to those of shareholders. Delaware's law gives shareholders a private right of legal action to enforce the social purpose and commitment to stakeholders.

B Lab agreed to "grandfather" in the early companies, giving them time to register under the new state law. In its filing Etsy states that if its board "approves an amendment to our certificate of incorporation specifying that we become a public benefit corporation," holders of more than 5 percent of the company's stock are obligated to support it.

Etsy's prominent investors include Accel Partners, Union Square Ventures, Index Ventures and Tiger Global Management, notably none of which identify as "impact" investors. Venture capitalists Jim Breyer and Fred Wilson also own significant portions of the company.

"Investors are nervous about the private right of action in the public benefit corporation statute, but founders want to retain the B Corporation certification," says attorney Todd Johnson, who heads the Silicon Valley office of Jones Day. He also serves as ImpactAlpha's outside legal counsel. "This tension, and a general market lack of sophistication, creates some uncertainty around how the market will value B Corporation certification."

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According to Etsy's B Corp profile, the company's core services empower people to change the way the economy works so that "very-very small businesses have much-much more sway in shaping the economy; local living economies are thriving everywhere, and people value authorship and provenance as much as price and convenience."

Additionally, Etsy pays its part-time workers 43 percent more than the local living wage, composts more than 600 pounds of food waste each month at local community farms and supports projects that train women and minorities in programming skills, according to their profile.

Etsy's evolution as a publicly traded company will be watched closely as it seeks to generate profits while remaining committed to its mission. It has already faced criticism for its decision in 2013 to allow manufactured goods to be sold on the platform along with handicrafts.

"People often ask me how I choose between the success of our community and the success of our business," wrote Dickerson. "My answer is that I don't have to choose; we have built a business that does well when our community is successful."

Related: How a Grassroots Fund Profits From Looking Beyond the Money

Impact

Financial

Etsy's sellers generated sales of $1.93 billion last year, up 43.3 percent from the previous year. The company reported revenue of $195.6 million last year, up 56.4 percent over 2013, and a net loss of $15.2 million, up from a net loss of $0.8 million.

Social

As of December 2014, Etsy had connected 54 million members, including 1.4 million active sellers and 19.8 million active buyers. A 2013 study found selling creative goods is the full-time occupation of 18 percent of Etsy entrepreneurs. Seven out of eight Etsy sellers are women.

Produced by ImpactAlpha and the Case Foundation.

One of a series of impact profiles produced in conjunction with the Case Foundation's publication, "A Short Guide to Impact Investing."

Editors Note: *This article has been corrected to clarify the process by which Etsy may become a public benefit corporation under Delaware law.*

PRIVATE CAPITAL
PUBLIC GOOD

How Smart Federal Policy Can Galvanize Impact Investing — and Why It's Urgent

JUNE 2014

US NATIONAL
ADVISORY BOARD
ON IMPACT INVESTING

WHO WE ARE

As part of the June 2013 G8 meeting, an international effort was undertaken to explore the possibilities for impact investing to accelerate economic growth and to address some of society's most important issues.

Under the auspices of that effort, the United States **National Advisory Board** was formed to focus on the domestic policy agenda. The board is comprised of 27 thought leaders, including private investors, entrepreneurs, foundations, academics, impact-oriented organizations, nonprofits, and intermediaries.

The group's purpose is to highlight key areas of focus for US policymakers in order to support the growth of impact investing and to provide counsel to the global policy discussion.

This report is the result of a collaborative process. Each member of the National Advisory Board (NAB) brings different perspectives and priorities to this effort. Members of the NAB have participated in their capacity as individuals, rather than representatives of their organizations. The report represents the collective perspectives of the group, rather than the specific viewpoints of each individual.

EXECUTIVE SUMMARY

A movement is afoot.

It reaches across sectors and across geographies, linking small-business loans in Detroit with community development financing in Delhi. It has animated a generation of entrepreneurs and captured the imagination of world leaders. It links the social consciousness of philanthropy with the market principles of business. It's about how **the power of markets can help to scale solutions to some of our most urgent problems.**

The movement is called **impact investing**. It brings together entrepreneurs, investors, foundations, public-sector leaders, nonprofits, and intermediaries to use private capital for public good. **Simply put, impact investing generates measurable, beneficial social or environmental impacts alongside financial returns.** It's a simple idea with profound implications.

For all the media coverage impact investing has earned recently, **it is not a new concept**. It has deep historical roots. Impact investing was built in partnership among investors, foundations, and the US government over the course of decades. Today, impact investors finance undertakings from early childhood education to global economic development, from preventive health care services to village-based solar microgrids.

We are at an inflection point in the impact investing movement. New energy has enlivened the space. A recent report from J.P. Morgan and the Global Impact Investing Network (GIIN) of 125 major fund managers, foundations, and development finance institutions found $46 billion in impact investments under management, a nearly 20 percent increase from the prior year.[1] But impressive as that progress sounds, impact investments still represent only 0.02 percent of the $210 trillion in global financial markets.[2] For all its promise, the movement is not yet living up to its potential—which many believe to be 10 or even 20 times its current size.[3] **For impact investing to reach massive scale—bringing private capital to bear on our greatest problems—it will require a more intentional and proactive partnership between government and the private sector**.

This report highlights strategies for how the government can partner with impact investors to unleash new capital, talent, and energy for social, economic, and environmental good. Members of the National Advisory Board, who produced this report along with input from many others, are part of a growing group of skilled investors, entrepreneurs, and intermediaries who believe that capital can be used more reliably and effectively as a tool for long-term progress. Together, we explored a range of government policies to advance impact investing. The policies we recommend build on the historical successes of the field. **Many policies do not require any additional government spending; those that do often repay their costs over time.** This report is the product of months of discussion, extensive consultation, and deliberation. While each of the members of the NAB brings different priorities and perspectives to this effort, all agree that **we are at an inflection point where smart policy can scale smart capital for social benefit.**

Policy matters greatly to scale effective solutions. Strong and purposeful partnerships among governments, investors, entrepreneurs, and philanthropists are essential to tackle the increasingly complex and difficult public concerns we face. **Government plays a vital role.** It can modernize rules, improve key programs, and promote areas of mutual benefit. Ultimately, it can help mobilize the talent and capital to tackle core social and environmental challenges at scale.

In light of what we face as a nation, **there is no excuse for leaving willing talent and capital sitting on the sidelines.**

STRATEGY 1

Remove regulatory barriers to unlock additional private impact investment. Innovative impact-oriented businesses are in need of investment, and certain regulatory barriers stand in the way—leaving much private capital on the sidelines. For example, the IRS could further clarify and refine its rules about foundation investments in for-profit enterprises to help fill the funding gap between grants and commercial capital. This would be cost neutral.

STRATEGY 2

Increase the effectiveness of government programs. Government agencies frequently lack the flexibility and range of tools needed to achieve social and environmental goals. For example, Congress could revise the longstanding investment restrictions under which the Overseas Private Investment Corporation operates, so that it could participate in a wider range of impact investments, reinvest its proceeds for portfolio growth, and develop next-generation financial instruments and models. These policies would increase the environmental and social impact of programs while lowering costs or potentially increasing revenue.

STRATEGY 3

Provide incentives for new private impact investment. Some markets need a push to get off the ground. By putting the first dollar on the table, government can attract private investment to support important social and environmental goals. More federal agencies should have the authority to replicate successful impact investing programs, such as the Community Development Finance Institution (CDFI) Fund, which marshals $20 of private capital for every $1 of federal funds invested. These policies may increase agency expenditures, but they often repay their costs over time or attract considerable private funding.

SUPPORTING POLICY AREA

Encourage and support innovative impact-oriented organizations and impact investment opportunities. Every entrepreneur needs support in getting off the ground. Congress, the White House, and government agencies command powerful public platforms for spreading the word about the benefits of impact investing. They can support the development of field-building organizations.

SUPPORTING POLICY AREA

Standardize metrics and improve data access. Measuring impact is critical to the development of the impact investing field. The government can support and accelerate private-sector standards while promoting open access to data. For example, development finance institutions could coordinate to create a platform that enables data sharing and due diligence, modeling their efforts after the Department of Education's Investing in Innovation (i3) fund.

CONTENTS

This report provides a framework for federal policy action in support of impact investing. This is a bipartisan effort. Even during this time of great political polarization, many of the measures described here support the values and goals of constituencies across parties. Collectively, these proposals—some near-term and concrete, others longer-term and more ambitious—have the power to unlock dramatic economic activity and immense positive impact. Ultimately, they may serve as a catalyst to help change the way investors think about long-term risks and returns.

INTRODUCTION

A new generation of entrepreneurs is reshaping how we think about the role of business in solving our most urgent social problems. These entrepreneurs, domestic and global, seek both profit and social or environmental impact. Their blended missions can blur the traditional division between for-profit and nonprofit enterprises, between commercial investment markets and their philanthropic counterparts. It's a quiet revolution in the making.

Impact-oriented organization: an enterprise—for-profit or nonprofit—that seeks to address social or environmental concerns while seeking sustainable financial returns.

The transformation has reached school cafeterias. Concerned about epidemic childhood obesity[4] and mounting evidence that school lunches share part of the blame,[5,6,7] two business school friends (and moms) decided to start a company to provide nutritious lunches to school kids across America. Kristin Richmond and Kirsten Tobey launched Revolution Foods in 2006 with mixed financing from a diverse range of sources, including both impact investors and private venture capital firms.[8] Today, Revolution Foods has contracts with school districts in 27 cities across 11 states, and provides 1 million healthy meals each week to school children, 75 percent of whom are low-income.[9] The firm has been listed by *Fast Company* and *Inc.* magazines as one of the nation's fastest-growing and most innovative companies.[10]

Half a world away, US-born entrepreneurs Nikhil Jaisinghani and Brian Shaad struggled with a different problem: over 400 million people in India lack access to electricity, a critical need to boost economic growth, improve health, and advance education. That inspired Jaisinghani and Shaad to found Mera Gao Power (MGP) to sell microgrids—solar powered small-scale electrical systems—whose up-front costs can be shared across a village, enabling households to buy energy at half the cost of kerosene.[11] USAID's Development Innovation Ventures program awarded MGP a $300,000 grant, allowing the organization to reach 25,000 people in 222 villages across Uttar Pradesh in northern India—and to become profitable. After proving that their business model worked, MGP secured equity financing from Insitor Management, an impact investment firm, to fund further expansion.

Richmond, Tobey, Jaisinghani, and Shaad are four actors in a growing global movement—extending beyond entrepreneurs to include nonprofits, governments, and major corporations—that aims to marshal public and private resources to reshape where investors decide to place their capital and how we think about business.

This philosophical shift—the blending of purpose and financial reward—comes not a moment too soon. The magnitude of our most important problems eclipses the public and philanthropic resources currently allotted to combat them.[12] Government dollars will fall short of supporting our national interests, both at home and abroad—whether that means increasing employment, supporting global development, or improving education to boost our global competitiveness. Philanthropy, while growing, will not be sufficient to fill the gap. Fresh thinking, innovative funding approaches, and new financing models are needed to complement traditional systems.

PAYING FOR SUCCESS

Social impact bonds (SIBs) are tools to finance government pay-for-success contracts. Investors provide up-front funding for a program of prevention or early intervention services that are currently beyond the reach of limited government funding. If the program hits performance targets and saves the government money, government uses some of the savings to repay investors with interest. If the program fails, government owes the investors nothing.

To date, most US social impact bonds have been state-, county-, or city-led, with philanthropy playing a critical role to mitigate risks. In 2013, following in the footsteps of the nation's first SIB launched in New York City, the State of New York, Social Finance US, and Bank of America Merrill Lynch announced the first SIB globally offered to investors via a mainstream wealth management platform. The $13.5 million raised from more than 40 individual and institutional investors will be used to expand the work of the Center of Employment Opportunities (CEO), a successful provider of employment and reentry services to formerly incarcerated individuals. The Rockefeller Foundation provided a first-loss guarantee of 10 percent, helping to lower the risk for other investors. If the program is successful at reducing recidivism and increasing employment relative to a control group, as determined by a randomized control trial, investors recoup their principal and can earn up to a 12.5 percent rate of return. Social Finance, as intermediary, will also provide ongoing performance management and project oversight throughout the life of the five and one-half year project.[41]

Enthusiasm to meet this challenge has galvanized investors, entrepreneurs, foundations, public-sector leaders, nonprofits, and intermediaries, who—under the banner of impact investing—are dedicated to targeting and tracking social or environmental value alongside financial return. Hundreds of fund managers, including those at the nation's preeminent financial institutions, are raising capital in the impact investing field from high-net-worth individuals and pension funds alike.[13] Giving Pledge members, some of our nation's most successful entrepreneurs, described impact investing as "the hottest topic" at their 2012 meeting and are forming a community of practice among themselves to share lessons learned.[14]

This year, impact investors will channel billions of dollars to finance early childhood education, innovations in clean technology, financial services for the poor and struggling middle class, and other impact areas. Some of this investment is catalyzed by tax credits or regulatory mandates. Other investments are driven by forward-thinking policymakers embracing new investing tools that can augment traditional grant making—building on successful models in housing, infrastructure, and other sectors. Leveraging the scale and dynamism of markets, these public-private innovations can bring effectiveness, accountability, and scale to important services to complement public-sector commitments.

Impact investing is not a panacea. Private capital alone will not solve tough social problems. But impact investing can pave the way for more effective, proactive investment across the public and private sectors and help move talent and capital interested in both social and financial returns into the mainstream. In light of what we face as a nation, there is no excuse for leaving willing talent and capital sitting on the sidelines.

SEIZING THE OPPORTUNITY

Investment can produce economic value, create jobs, and improve our standard of living. Increasingly, investors across a wide variety of sectors recognize that explicitly focusing on these outcomes can impact their bottom lines, helping them to refine their focus, plan effectively for long-term risks, and capitalize on a growing movement of socially conscious consumers.[15] Both microfinance and community development, for example, have for decades driven positive change in underserved communities. Impact investing is firmly rooted in, and expands upon, these important historical movements.

Impact investors are a diverse group, seeking a wide variety of social and financial objectives. Some, including institutional and other mainstream investors, seek risk-adjusted market-rate returns. Often, these funds focus on more mature sectors, such as microfinance and community development

A BRIEF HISTORY OF IMPACT INVESTING

Investing with social purpose is not a new phenomenon. Here are some of the highlights of its development.

1950

Following WWII, the US government began providing political risk insurance to private investors doing business abroad.

1958 Small Business Investment Company

1960

In 1961, President Kennedy created USAID to fund global development.

In 1968, the Ford Foundation began experimenting with Program-Related Investments (PRIs; see page 24 for further detail) that offered the potential for social change while returning investment principal for future use.[16]

1970

In 1971, as international aid grew, USAID incubated development finance operations, leading to creation of the Overseas Private Investment Corporation. The 1970s also saw the launch of Grameen Bank and the microfinance industry.[17]

1977 Community Reinvestment Act

1980

In the 1980s and 1990s, socially responsible investors—who attempt to avoid investments deemed harmful to society—diverted capital from South Africa to pressure leaders to end apartheid.[18]

1986 The Low-Income Housing Tax Credit

1990

In 1994, Congress passed the Riegle Community Development and Regulatory Improvement Act, which promoted access to capital and local economic growth via community development financial institutions (CDFIs).[19]

2000

By the first decade of the 21st century, the Foundation Center tracked 427 foundations that financed nearly 4,000 PRIs for a total of over $3 billion—significant progress, but still a fraction of the more than $200 billion in grants given over the period by the nation's top 100 foundations.[20,21]

2000 The New Market Tax Credit

2007

In 2007, recognizing this proliferation of socially minded investment activity, the Rockefeller Foundation convened a meeting in which several leaders in finance and philanthropy coined the term "impact investing."[23] As The Monitor Group, a consultancy, observed in a seminal 2009 report, this marked a transition in the impact investing industry's evolution from a stage of "uncoordinated innovation" to a more unified phase of "market building."[24]

2010

By 2012, The Forum for Sustainable and Responsible Investment reported that the socially responsible investment market had grown to over $3.7 trillion.[22] Impact investors began to work in concert to build industry infrastructure and centers of investment activity, such as the Global Impact Investing Network (GIIN) and the Global Impact Investing Rating System (GIIRS). Through these market-building efforts, GIIN has defined impact investments as "investments made into companies, organizations, and funds with the intention to generate social and environmental impact alongside a financial return."[25]

2012 First Social Impact Bond in the US

IMPACT INVESTING has become a popular topic of discussion among investors, heads of state, and social entrepreneurs attending the **World Economic Forum Annual Meeting** in Davos, Switzerland. And the Obama Administration has made impact investing a central feature of its Power Africa initiative, which seeks to leverage billions in private finance to double the number of people with access to energy systems in sub-Saharan Africa.[26]

finance, or high-growth, high-risk industries, such as emerging markets infrastructure. In one study of self-reported data, for example, Elevar Equity's, investments in the microfinance space returned 21 percent to investors.[27] Other funds, often capitalized by philanthropic sources, intend to pioneer new markets and build sustainable industries. These funds may be working in fields traditionally supported through public finance (such as water, sanitation, or education). They focus on underdeveloped geographies or target consumers with low incomes, providing scalable and sustainable pathways to reach the world's poorest. They may also help an enterprise or market reach commercial viability, where it can scale through private sector markets and begin to attract commercial investors. Such funds may accept returns below commercial rates. For example, Accion Texas returned 2–3 percent to investors from its US-based small-business loans.[28] In the absence of more transaction data, it is too early to systematically assess risk-adjusted rates of return, but these examples of pioneer investors suggest the breadth of potential objectives that can be accomplished using the tools of impact investing.

Sometimes, investors from across this spectrum of purpose join together to create innovative solutions. The Collaborative for Healthy Communities, a $130 million initiative to fund community health centers across the country, is one such example. The Collaborative makes use of a variety of financial tools and actors. It includes senior loan capital from Goldman Sachs' Urban Investment Group and three community lenders (Low Income Investment Fund, Primary Care Development Corporation, and The Reinvestment Fund), a subordinate loan from the Rockefeller Foundation, and a loan guarantee from the Kresge Foundation, reducing the risk for other investors.[29]

All of this comes as impact investing shows signs of robust growth. A 2014 survey from J.P. Morgan and the Global Impact Investing Network (GIIN) of 125 major impact fund managers, foundations, and development finance institutions identified $46 billion in impact investments under management, with annual funding commitments estimated to increase by 19 percent in 2014.[30] While this is significant, it remains a tiny fraction of the $210 trillion value of the world's equity market capitalization and outstanding bonds and loans.[31] Projections of future market size vary but are tantalizing. Sir Ronald Cohen, a leading British venture capitalist and impact investor (and chair of the Global Social Impact Investment Taskforce) believes the market's potential to grow to be as large as "the $3 trillion of venture capital and private equity." The field will provide increasing support to low-income housing, smallholder farms, affordable financial services, and more along the way.

Credit Enhancements: Methods of reducing risk for potential investors in order to increase private capital flow include:

Subordinated debt/first-loss capital: a loan or security that ranks below others in payout; in case of default, does not get paid out until senior or other higher-ranking debt holders are paid in full.

Partial risk guarantees: a form of insurance providing some limited protections against loss or default.

Today, these credit enhancement tools are being used across agencies, including:

Domestic investments: loan guarantees through the Small Business Administration for start-up expansion and through the Department of Energy for renewable energy technologies, subordinated debt such as Rockefeller's investment in the Collaborative for Health Communities, and many others.

Global development: partial loan guarantees through the USAID Development Credit Authority and Overseas Private Investment Corporation (OPIC), project preparation funds and barrier removal from the Africa Clean Energy Finance initiative (a multiagency project), and many others.

IMPACT INVESTING GAINS BROAD SUPPORT

In recent years, leaders in the social and financial sectors have demonstrated a growing commitment to impact investing. We highlight below key indicators of their commitment, and the benefits they hope to derive.

Businesses, from startups to multinationals, increasingly see opportunities to serve new markets with products and services that have explicit social impact. Revolution Foods, for example, is attempting to disrupt the world of school lunches, providing over 1 million healthy, affordable meals to students across the country, more than 60 percent of whom are in low-income households.[32] At the same time, many companies are also innovating for positive social and environmental impacts. Google has invested $1 billion in renewable energy projects,[33] and Coca-Cola is investing $1 billion in its 5by20 Program to develop business skills among 5 million women- and minority-owned suppliers by the year 2020.[34] Businesses including Patagonia and Etsy have become Certified B Corporations—for-profit entities that consider society and the environment in their business decisions—along with 1,000 companies from 60 industries that have signed on to assess themselves against higher standards of social and environmental performance, transparency, and accountability.

Investors at major financial institutions like Goldman Sachs and Morgan Stanley increasingly seek out impact investment opportunities. Some see impact investment as a way to diversify and strengthen their portfolios across new sectors, geographies, and time horizons; others use it to enable their clients to take a more active role in advancing their values. Increasingly, pension funds and other institutional investors around the world—which represent more than $80 trillion in assets under management in the 34 OECD nations alone—are beginning to warm to impact investments, such as those in renewable energy or in emerging markets, in search of higher yields and markets with long-term high-growth potential.[35]

High-net-worth individuals have shown tremendous interest in impact investing. High-profile entrepreneurs and investors, such as Steve and Jean Case, Vinod Khosla, Pierre Omidyar, Jeff Skoll, and George Soros have made significant commitments to impact investing to unleash the power of entrepreneurship to solve significant social and environmental problems. Others, such as Charly and Lisa Kleissner, have developed portfolios meant to demonstrate impact investing's ability to compete with traditional investments. Interest is likely to grow exponentially in coming years. Studies suggest that Millennials, who are poised to be on the receiving end of an intergenerational wealth transfer of $41 trillion in the coming decades, place considerable emphasis on aligning their investments with their values.[36]

Private foundations increasingly see impact investing as an important complement to grant making. The Gates Foundation manages a $1.5 billion commitment to income-generating program-related investments (PRIs); the MacArthur Foundation's PRIs now total $300 million;[37] and the Robert Wood Johnson Foundation announced a $100 million commitment to PRIs in 2011. Meanwhile, the F.B. Heron Foundation has set a pioneering example with its own endowment. After successfully deploying more than 40 percent of its assets to impact investing (while maintaining risk-adjusted returns), the foundation announced its intention to commit 100 percent. Foundations can make their balance sheets go even further by providing guarantees to private-sector investors to support high-risk investments.

Social service providers have been helped by philanthropy to test and refine ideas, but many are starved for growth capital to scale their work and meet urgent demand. Nurse-Family Partnership (NFP), for example, is a rigorously tested program in which trained nurses provide support for low-income, first-time mothers. Evidence from over 30 years shows that the program reduces costs to both state and federal governments, providing a powerful return on investment.[38] Impact investments—such as the social impact bond in development to support NFP in South Carolina[39]—could supply nonprofit direct-service providers with the capital needed to scale.

UNLOCKING GROWTH ABROAD: D.LIGHT

For-profit businesses—sometimes with the help of public risk capital—can produce both social impact and profitable returns. d.light, a B Corporation, manufactures and distributes solar lighting and power products to those who do not have access to reliable electricity, transforming lives in the developing world. Over eight years of growth (and with the help of a $1 million grant from USAID's Development Innovation Ventures), d.light has reached more than 30 million people.[42] The company recently completed an $11 million financing round—one of the largest investments in off-grid solar to date—from impact investors such as Acumen Fund, DFJ, Garage Technology Ventures, Gray Ghost Ventures, Nexus India Capital, and Omidyar Network.[43] This additional funding will accelerate its product technology development, expand its distribution, and allow it to aggressively pursue new opportunities.[44]

What does this mean? It means supporting socially minded businesses and entrepreneurs, whether they are bringing a grocery store to an urban food desert in Philadelphia; inexpensive solar electricity to rural villages in Kenya; or small-dollar, low-interest loans to the unbanked in San Antonio. It means testing innovative public-private financing models like "pay for success," which encourage government agencies to pay for measurable social outcomes and scale cost-effective preventive social services, such as asthma management or prisoner recidivism reduction. And it means doubling down on the progress we have made in the last quarter century, leveraging private capital for charter schools, financing low-income housing, and building small businesses where they are needed most.

At the same time, to truly scale these innovative solutions and produce widespread social change and economic value, investors across the public, private, and philanthropic sectors need to invest in market infrastructure. Like traditional financial markets, impact investing needs enabling policies; standardized performance measurement and reporting systems; third-party ratings and regulations; platforms to share market information and match capital with investments; educational programs to encourage impact investing; and easily accessible, transparent data to support investors in making disciplined investment decisions.

POLICY IN ACTION: INVESTING IN COMMUNITIES. The US government has a long history of legislative and regulatory support for impact investing. The Community Reinvestment Act (CRA), passed by Congress in 1977, helps to serve the credit needs of low- and moderate-income communities by encouraging financial institutions to serve their communities. Thanks to CRA, banks have actively promoted housing and economic opportunity for underserved groups by providing affordable mortgage programs, small-business loan products, community development financing, and more.[40] Since 1996, banks—in partnership with Community Development Finance Institutions which help to deploy funds, federal grants, and technical assistance—have reported more than $764 billion in small-business loans in low- and moderate-income communities.

We strongly support continuation of this critical policy.

FEDERAL POLICY AS A KEY LEVER FOR CHANGE

The impact investing industry stands poised for dramatic growth. The magnitude of that growth depends to a great extent on the degree to which the federal government will enact policy and regulatory changes to unleash the sector's potential.

Take, for example, the La'i'Opua Health Center, a new 11,500-square-foot medical center being built in the Kealakehe community of Hawaii's Big Island. In its first year, the health center—located in an underserved, low-income community—will provide medical and dental care to some 4,300 patients and add 25 full-time employees and another 10 part-time. The health center also serves as a catalyst for a broader area redevelopment plan that will include low- to moderate-income housing, a grocery store, a pharmacy, elementary schools, transit-oriented development, and a regional park. Yet the health center could never have been built without support from both private capital and public programs. The redevelopment plan relies on a bridge loan from the Nonprofit Finance Fund, matched with $10 million in tax credits from the federal New Markets Tax Credit program, and a grant from the Health Resources and Human Services agency of the Department of Health and Human Services.

Policy matters greatly. Government acts as regulator and standard setter, but also as coinvestor, risk mitigator, major buyer of goods and services, and sometimes as a market maker. The federal government exerts significant influence on where and how investors place their funds, regulating the use of pension funds, writing tax rules for foundations and others, and creating incentives to direct private capital. And the federal government is an extraordinarily powerful stakeholder with the ability to move and shape markets. It manages billions in domestic contracts, international development financing, and research funds; provides subsidies and credit enhancements; and builds market infrastructure.

With the leadership of forward-thinking policymakers, we can increase the efficiency and impact of public dollars, accelerate and expand the volume of private capital financing public goods, and use more of our country's most talented entrepreneurs on fixing our most urgent problems. Indeed, numerous case studies throughout this report demonstrate that it is possible to apply the power and discipline of markets to public goals—and that smart policy can generate tremendous leverage on limited government funds. Today, investment areas once considered tenuous—from low-income housing to charter school development—have been proven, thanks to innovative partnerships between private-sector leaders and the government. By continuing to cultivate new and deeper partnerships, we have the opportunity

CHANGING THE STAKES OF AFFORDABLE HOUSING: THE NYC ACQUISITION FUND

Impact investing challenges the public, private, and philanthropic sectors to turn innovative ideas into reality. The collaborative effort to relieve the shortage of affordable housing in New York City is a good example. In 2005, the city and several foundations—including Rockefeller, Robin Hood, and MacArthur—contributed $28.8 million to a capital pool that would absorb initial losses in the event of a loan default. This "first-loss" guarantee helped to attract a group of banks—including Bank of America, J.P. Morgan Chase, and Wells Fargo—that raised over $150 million, which has been used to build or preserve over 6,290 housing units. Mark Enterprise, a leading provider of affordable housing for low-income people across the country, acted as managing general partner of the fund and originator of the loan. This innovative partnership led to millions in new capital investment, with investor returns ranging from below-market (for the foundation group) to market-rate (for the bank consortium). In addition, it served as a model for other programs across the country, including those in Los Angeles and Denver.

to draw billions of dollars and untold amounts of entrepreneurial talent into the great task of solving our most persistent social problems and fostering economic prosperity for all over the medium and long term.

A NATIONAL POLICY PLATFORM FOR IMPACT INVESTING

The National Advisory Board that produced this report represents the diversity of the impact investing marketplace. We come from successful private enterprises, leading financial institutions, groundbreaking nonprofits, innovative universities, market-shaping investment funds, pioneering public agencies, and major foundations.

We come from different backgrounds, but we are united behind a clear vision of the future, one in which the federal government supports a bold vision of impact investing as an important tool for promoting the public benefit. Strong partnerships must be sustained and strengthened between government, private investors, foundations, intermediaries, the social sector, and entrepreneurs, in order to develop a thriving impact investing marketplace. And to reach its potential, this marketplace must provide investors with sufficient data to make informed investment decisions.

The policies described in this report—developed during an extensive review and consultation process (see appendix for further details)—range from modest to far-reaching. Neither the policies, nor the examples which illustrate them, are intended to be exhaustive representations of activity in impact investing. While state and local government have essential roles to play in further support of impact investing, these policies focus on the federal government. Some will require detailed and ongoing study; some entail staged change, building on the success of other policy recommendations. All, however, require immediate action to build support, develop model legislation or regulation, and enact the solutions that will help our communities, our country, and the world harness the power of private capital and entrepreneurial ingenuity to make lives better.

LEGISLATIVE ACTION

Approve the Treasury's Pay-for-Success Fund. (p.29)

Ongoing support for the Community Reinvestment Act (CRA). (p.16)

Ongoing support for The Community Development Finance Institution (CDFI) Fund, along with the Capital Magnet Fund (CMF), and funding for the National Housing Trust Fund (NHTF). (p.33)

Ongoing support for the Low-Income Housing Tax Credit (LIHTC) and the New Market Tax Credit (NMTC), including efforts to make the NMTC permanent. (p.35)

Review the tax code to target opportunities to support impact investments. (p.35)

Loosen regulatory and legislative constraints on the US Overseas Private Investment Corporation (OPIC). (p.26)

Remove investment restrictions on USAID's Development Credit Authority. (p.26)

Streamline access to development finance. (p.29)

JOINT ACTION & INFLUENCE

Promote flexible funding within agencies. (p.27)

Replicate model impact investing programs to stimulate private investment. (p31)

Encourage integrated public-private grant-investment capital funds for global development. (p35)

Use the influence of Congress, the White House, and federal agencies to celebrate impact-oriented entrepreneurs and businesses. (p.37)

Clarify standards for assessing production of income. (p.24)

Clarify that impact investing can be consistent with ERISA. (p.23)

Clarify standards for exiting program-related investments. (p.25)

Enable broader range of mission-related investments. (p.25)

Experiment with impact-oriented procurement. (p.30)

Support the growth and development of field-building intermediaries. (p.37)

EXECUTIVE ACTION

Conduct further research on unclaimed assets. (p.28)

Provide guidance regarding disclosure requirements. (p.23)

Revise visa investment criteria to redirect funding toward qualified impact investments. (p.29)

Broaden the scope of current federal capital access programs to include nonprofits. (p.32)

Designate a third party to develop a visible public framework to identify key bureaucratic barriers to impact investing. (p.25)

Endorse a framework for more robust impact measurement and standards. (p.38)

Develop multilateral, pooled vehicles to fill gaps in early-stage risk capital. (p.34)

Replicate innovative data-sharing efforts. (p.40)

Encourage agencies to fund enterprises, not just projects. (p.28)

Experiment with Development Impact Bonds. (p.30)

Increase guarantees to mobilize greater US institutional capital for impact investing abroad. (p.33)

DOMESTIC

INTERNATIONAL

CROSS-CUTTING

A FRAMEWORK FOR FEDERAL POLICY ACTION

1 REMOVE REGULATORY BARRIERS TO UNLOCK ADDITIONAL PRIVATE IMPACT INVESTMENT

Policies should support rather than impede effective public and private solutions to our most pressing social and environmental challenges. However, current interpretations of the federal laws around fiduciary duty hamper the ability of investors to take these factors into account in their investment decisions. Federal officials should address these issues by revising regulatory guidance, particularly for pension funds and private foundations.

MODERNIZE REGULATION OF FIDUCIARY DUTY

Impact investing is consistent with the role of a responsible fiduciary. Indeed, a long-term understanding of social and environmental impacts is becoming an increasingly important element of making prudent investments. However, some interpretations of fiduciary duty have not kept pace with this understanding.

Policy can help to support this trend toward a more inclusive understanding of fiduciary duty. In particular, regulators can clarify ERISA regulations for pension funds and further support the rise of new corporate forms with expanded fiduciary duties.

Under the Employee Retirement Income Security Act (ERISA) of 1974—which regulates trillions in pension fund investments[56]—pension plan fiduciaries must act prudently, diversifying their investments to minimize the risk of large losses, and must act for the exclusive benefit of plan participants and beneficiaries. Over the years, the US Department of Labor (DOL), which enforces these requirements, has provided guidance in its interpretation of the law. In the late 1970s, for example, DOL clarified that investments in venture capital funds could be consistent with ERISA guidelines, helping to launch the industry.

In 1994, building on its long-term informal direction,[57] DOL provided formal guidance that plans could consider targeted economic, environmental, and other concerns, so long as doing so was consistent with the fiduciary obligation to the plan participants—that is, providing the same level of return at the same level of risk as comparable investment alternatives.[58] In 2008, the Department of Labor changed its guidance. It said that fiduciaries "may never subordinate the economic interests of the plan to unrelated objectives," and that they could not make investment decisions based on "any factor outside the economic interest of the plan," with the exception of rare, specified circumstances.[59] The changes sent an important signal to investors. Whereas the previous guidance had been taken as a mechanism of supporting

> Fast Fact: Standards of prudence evolve over time. As recently as the 1970s, stock investments were widely viewed as imprudent for trust fiduciaries.

THE CHANGING DYNAMICS OF FIDUCIARY DUTY

In recent years, numerous examples suggest the changing dynamics of fiduciary duty.

- Research, such as that conducted by CFA Centre for Financial Market Integrity and the Business Roundtable Institute for Corporate Ethics, studied investor time horizons and concluded that "the obsession with short-term results by investors, asset management firms, and corporate managers collectively leads to the unintended consequences of destroying long-term value, decreasing market efficiency, reducing investment returns, and impeding efforts to strengthen corporate governance."[47] For many, this suggests that fiduciary norms that exclude such long-term factors are unjust, particularly from an intergenerational perspective.[48] Education and culture change will be essential to training the next generation of global business leaders about the importance of accounting for long-term risks in their investment decisions.

- In 2010, the US Securities and Exchange Commission issued guidance on disclosure of climate risk information by publicly listed companies, suggesting that environmental concerns are important potential investment concerns.[49]

- The Sustainability Accounting Standards Board (SASB), a nonprofit supported by foundations and corporations, is developing industry-specific sustainability accounting standards to provide investors with insights into factors that will materially influence their financial decision–making.[50]

- University endowments, private foundations, and others have chosen to incorporate long-term environmental, social, and other factors into their investment strategies. For example, Stanford University recently decided to divest its endowment funds from coal mining companies.[51]

- Over 1,200 investors with $34 trillion in assets—including CalPERS, the second-largest public pension fund in the United States,[52] and the Norwegian Government Pension Fund, one of the world's largest sovereign wealth funds—have joined together to support the United Nations Principles for Responsible Investment. Members of the global network believe that environmental, social, and governance issues pose risks to their portfolios and may harm the interests of their beneficiaries.[53] They see consideration of these factors as an essential component to upholding their fiduciary duty—that is, to maximizing long-term returns for their beneficiaries. They are part of a sea change in financial markets. According to KPMG, 93 percent of the world's largest 250 companies report on non-financing factors.[54]

- Other countries have altered their fiduciary regulations. For example, South Africa now requires that investors "consider any factor which may materially affect the sustainable long-term performance of the investment, including those of an environmental, social, and governance character."[55]

impact investments, the 2008 guidance created the opposite impression.[60] As a result, some investors are reluctant to take environmental or social factors into account when determining the economic benefit of an investment. For example, a fiduciary might be concerned that consideration of significant environmental disruption from climate change—and the related effects of current and future public policies—might be seen as outside the "economic interest of the plan," even though it will influence returns within the lifetime of plan participants.

We believe it would be beneficial for the Department of Labor to make it clear that consideration of targeted economic, environmental, and social factors is consistent with ERISA's fiduciary obligations to plan participants. Specifically, we recommend that the Department of Labor:

› **Clarify that impact investing can be consistent with ERISA.** The Department of Labor should make clear that ERISA fiduciaries may consider environmental, social, and governmental factors in making investment decisions, and that doing so is consistent with their responsibility to act in the economic interest of the plan. This change could dramatically increase the private capital available for impact investment. Even a small percentage of the trillions in pension funds governed by ERISA could create enormous public benefit.

Even as pension funds confront the meaning of fiduciary duty, states are leading the charge in redefining the role of prudent corporate citizenship. Twenty-seven states—from Oregon to Arkansas to Delaware—have introduced a new corporate form, the benefit corporation, designed for businesses that consider society and the environment in addition to profit in their decision-making process. To support these businesses, we recommend that regulators:

› **Provide guidance regarding disclosure requirements.** The Securities and Exchange Commission should explicitly provide guidance around the disclosure requirements and investor regulations of companies with expanded fiduciary duties, such as B Corporations.

POLICY IN ACTION: FEDERAL POLICY REVITALIZES VENTURE CAPITAL

In the 1970s, the young field of privately managed venture capital nearly faded away.[45] However, seeing the potential for unleashing innovation and growth, the US government stepped in with a series of smart policy changes to revive the industry. In 1979, clarifications to ERISA's "Prudent Man" rule allowed pension funds for the first time to make venture investments. The following year, two new policies increased venture funds' flexibility: the Small Business Investment Incentive Act removed the need for venture firms to register as investment advisors, while the ERISA "Safe Harbor" regulation clearly stated that VC managers would not be considered plan fiduciaries. At the same time, capital gains rates were cut twice, from 49.5 percent in 1979 to 20 percent by 1981. Over this period, VC investment skyrocketed from nearly zero to over $5 billion. Entrepreneurship has never been the same. Today, venture-capital-backed companies account for 12 million US jobs and over $3.1 trillion in revenue (based on 2010 data), according to IHS Global Insight's 2011 Venture Impact study.[46] Removing regulatory barriers and providing incentives helped to spur the rebirth and serve as a driver of US innovation.

ENCOURAGE INCREASED IMPACT INVESTING BY PHILANTHROPISTS

As inherently mission-driven institutions, private foundations have been among the most active proponents of impact investing. Foundations use two main impact investing tools: investments aligned with their mission and expected to generate a financial return (mission-related investments, or MRIs),[61] and investments that are primarily charitable in purpose (program-related investments, or PRIs), which also count toward a foundation's mandated annual 5 percent grant payout.

For foundations, both MRIs and PRIs are sustainable tools for supporting their mission and programmatic work—fueling growth of mission-driven organizations while returning the invested principal for use in future investments. Both MRIs and PRIs perform a crucial function for impact-oriented organizations, filling the funding gaps between grants and commercial capital. For example, in 2009 the Kellogg Foundation made a $500,000 MRI in Acelero Learning, a for-profit company that supports and manages high-quality Head Start programs in Nevada and New Jersey.[62] That same year, the Bill & Melinda Gates Foundation made a $10 million PRI (alongside a $4 million grant) in Root Capital—a nonprofit social investment fund—to provide affordable credit to small agricultural businesses in Africa and Latin America.[63]

Nevertheless, current practices and guidelines perpetuate an investment blind spot. There are some impact investments, particularly in new or higher-risk ventures, that lie between what is considered acceptable for an MRI (based on the fiduciary duty of endowment management) and the special requirements for PRIs (that they be charitable and not primarily intended to produce financial returns). Foundations are particularly well suited to bridge the pioneer gap in these types of situations, but their ability to do so today is limited—due to both cultural and organization divisions between managers of PRIs and MRIs, and to existing regulations that may place unnecessary constraints on the continued growth of these important impact investment vehicles. While foundations themselves—such as the F.B. Heron Foundation and Omidyar Network—are experimenting with new methods of integrating their investment teams and philosophies, we encourage continued evolution in PRI and MRI regulation.

Efforts to clarify and simplify the process of making PRIs have already made important progress. The IRS recently issued clarifications supporting a broader set of examples, and the proposed Philanthropic Facilitation Act would streamline the approval process for eligible charitable investments. The IRS should continue to update examples periodically in order to keep up with growing opportunities for impact. It should also provide greater clarity to its definition of charitable purpose in order to provide greater comfort to foundations seeking to address new or emerging challenges.

In addition, two further evolutions of PRI regulation could make the process of program-related investing even more straightforward for foundations:

- **Clarify standards for assessing production of income.** Opportunities for impact investment have changed significantly since PRI regulations were originally written. The IRS should clarify standards for assessing production of income such that foundations are not precluded from: (a) using a traditional commercial investment analysis or approach to review the strength of an investment; or (b) investing alongside for-profit investors without having to be concerned about other investors' motives for investing. These clarifications could be accomplished by an update to PRI regulations, a revenue ruling, or possibly a strategically developed private-letter ruling.

- **Clarify standards for exiting program-related investments.** Today, while foundations can stay in profitable PRIs (so long as the investee's mission has not changed dramatically), the perception is that foundations lack flexibility in determining when to exit a PRI. The IRS should clarify that a foundation should use its best judgment (including delaying an exit until it is prudent to do so), and in doing so would not violate expenditure responsibility.

Looking beyond today's PRI regulations, another more fundamental change could ease the process for making higher-risk investments:

- **Enable a broader range of mission-related investments.** To provide private foundations greater latitude and expand the range of potential MRIs, the IRS should consider updating standards for "jeopardizing investments"[64] with language from UPMIFA (state-level legislation governing the investment practices of charitable institutions) which allows consideration of "an asset's special relationship or special value, if any, to the charitable purposes of the institution."

Beyond rule changes, we also believe that federal agencies should continue to support and encourage foundations to make MRIs and PRIs. Increasing excitement about these tools and knowledge of rules governing them can help more foundations to make their scarce funds go further.

LOOKING FORWARD: ONGOING EVALUATION OF BARRIERS

To drive change across federal policy, it will be important to maintain a consistent review of key barriers to impact investment. To do so, policymakers could:

- **Designate a third party to develop a public framework to identify key bureaucratic barriers to impact investing.** Issue a broad call to action for regular review of regulatory, policy, tax credit, and capital programs to identify barriers, propose solutions, and establish principles to avoid these barriers in new legislation and rule making. Use this "diagnostic" framework to build an ongoing action plan and database similar to the World Bank's Ease of Doing Business index.[65] This process would likely begin as an external review from a think tank, but could ultimately be incorporated within current government processes (e.g., scoring of proposed rules).

2 INCREASE THE EFFECTIVENESS OF GOVERNMENT PROGRAMS

Federal agencies have an imperative to use taxpayer dollars to get the best outcomes for the people they serve. Current rules, however, can hold agencies back from reinvesting in programs that work or from innovating to improve program performance. Policymakers should unleash the power and creativity of agency programs to engage in impact investing.

INCREASE AGENCY FLEXIBILITY

Agencies face a variety of barriers to increasing the reach of impact investing programs. They may be limited by internal policies and guidelines, lack of precedent or examples of previous success, or by explicit congressional or regulatory guidelines. We need to increase the effectiveness of agencies, allowing them to tackle old problems with new tools. To do so, Congress and agencies could:

- **Loosen regulatory and legislative constraints on the US Overseas Private Investment Corporation (OPIC).** OPIC is a government agency whose mission is to promote international development by encouraging US investment in emerging markets. It helps American businesses expand into the developing world through debt financing, guarantees, political risk insurance, and support for private equity investment funds. OPIC produced net income of over $436 million in 2013, and has returned profits to the US Treasury for over 30 consecutive years.[66] It has also created significant sustainable development impact through the projects it supports. Nevertheless, it could generate even greater economic, social, and environmental returns if Congress changed some longstanding constraints on OPIC's investments and administration.

  Since 2007, OPIC has been reauthorized on an annual basis.[67] We recommend that Congress give OPIC permanent reauthorization, or revert to multiyear reauthorizations, thereby reducing uncertainty and improving OPIC's ability to secure long-term private-sector partnerships.[68] In addition, Congress should allow OPIC to retain a modest portion of its earnings to increase its staffing. Currently, OPIC has roughly $12 billion in additional deployable investment capital but does not have an adequate administrative budget to fully deploy that capital while maintaining stringent portfolio oversight. OPIC also lacks the authority to make early-stage equity investments. We suggest that Congress provide it with the flexibility to pilot these investments. Finally, Congress should consider updating the requirement that OPIC only support projects with meaningful connections to US citizens or businesses. An exception, for example, could be instated for the world's poorest countries. No other major development finance institution has this kind of nationality restriction. Broadening it in limited circumstances would help OPIC to advance its core development objectives and allow select investments based entirely on their combined social-financial value.[69]

- **Remove investment restrictions on USAID's Development Credit Authority.** Regulations similarly constrain another of our most effective development finance programs. USAID's Development Credit Authority (DCA) uses partial loan guarantees to demonstrate that underserved businesses in the developing world are commercially viable and creditworthy borrowers. In the past two years alone, DCA has used its $8 million annual budget to leverage over $1 billion in private investments.[70]

BUILDING FLEXIBILITY

Skyrocketing home prices in the San Francisco Bay Area have made it nearly impossible for low-income families to find homes close to public transit.

In response to this problem, the Metropolitan Transportation Commission creatively repurposed its federal transportation funds to leverage public and private capital, raising $50 million for the Bay Area Transit-Oriented Affordable Housing Fund (2006-2011).[72]

The fund includes capital from a variety of sources (see right). The funds from Morgan Stanley and Citi Community Capital were motivated by the Community Reinvestment Act, a Federal law passed in 1977 that requires banks and savings associations to invest in low- and moderate-income neighborhoods.[73]

To date, the fund has invested $29M in seven projects.

$50M Bay Area Transit-Oriented Affordable Housing Fund

$25M
Senior Bank Financing: Morgan Stanley and Citi Community Capital

$8.5M
Loan Originators: Consortium of community development finance institutions

$10M
First Loss Financing: Federal dollars creatively repurposed by Metropolitan Tranportation Commission

$6.5M
Subordinate Debt: Ford Foundation, Living Cities Catalyst Fund, San Francisco Foundation

PROJECTS COMPLETED	HOUSING UNITS DEVELOPED	AFFORDABLE HOUSING UNITS
7	779	83%

Moreover, DCA-supported borrowers have a 98 percent loan repayment rate.[71] However, congressional appropriations language has limited the organization's authority to work with other financial guarantors, which would greatly expand its scale, reach, and impact. DCA is limited not simply by level of risk exposure ($300 million per country)—a prudent method of limiting taxpayer liability—but also by the total face value of loans guaranteed (currently $1.5 billion, with a proposed FY 2014 limit of $2 billion), regardless of the agency's stake in those loans. This regulation deters DCA from creating scaled deals at lower exposure to taxpayers. Like OPIC, DCA's administrative budget also remains highly constrained. With a modest increase in annual appropriations (e.g., $2-3 million), it could expand its operations and help unlock hundreds of millions of dollars more in private capital every year.

› **Promote flexible funding within agencies.** Grant makers and development specialists both at home and abroad often do not have clear guidance or permission to support impact investing. While many creatively find ways to provide financing to impact-oriented organizations, they do so in spite of constraining traditions and outdated internal policies. Where possible, agencies should work to encourage

STATES LEADING THE CHARGE: UNCLAIMED ASSETS

In the world of impact investing, state governments are key actors in advancing innovation. As described in this report, state and municipal actors have been early adopters of social impact bonds (see page 10) and have long worked with communities to finance sustainable development and create jobs.

One potential untapped source of impact investing funds may lie in the unclaimed assets of dormant bank accounts.[76] Following in the footsteps of the UK government—which used unclaimed bank assets to launch Big Society Capital, a social investment bank—the United States could seek to use these funds for impact investments. Each state, however, has its own set of regulations and programs governing these funds. Further research should be undertaken to demonstrate how states can use unclaimed assets to create public good, and how the Treasury can support states to build innovative funds with these assets.

experimentation with impact investing—structuring grant funds in more dynamic ways, such as first-loss guarantees or pay-for-success arrangements. It can also help to repurpose agency funds for innovative programs. Modifications to HUD's $5 billion Hurricane Sandy Community Development Block Grant permitted recipient states to use up to 15 percent of their federal funds in pay-for-success arrangements, providing a model for creative flexibility.[74]

- **Encourage agencies to fund enterprises, not just projects.** Many agencies and financial institutions track success and make investment decisions on a project-by-project basis. However, this approach makes clear lines of accountability across service providers difficult to track, drives up transaction costs, and makes efficient organizations difficult to reward and scale.[75] Agencies that invest in enterprises or intermediaries (e.g., the US Treasury via the Community Development Financial Institutions program), however, can clearly track successful investments across their portfolios and increase support for effective organizations. Investing in organizations—through grants, loans, or equity—builds their capacity, and strengthens their balance sheet over time. As a result, investments in organizations have the potential to generate multiplier effects. If new funds, such as the National Housing Trust Fund, could be used to make equity investments in housing organizations, such funds could help catapult a group of high-performing affordable housing organizations to a new level of scale and efficiency.

SUPPORT CROSS-AGENCY CONNECTIONS

The work of agencies—particularly in the realm of economic development—often overlaps. Agencies can capture synergies and efficiencies by proactively working together toward common goals, sharing data, agreeing on key impact measures and definitions, and coordinating investments. For example, they could:

- **Revise visa investment criteria to redirect funding toward qualified impact investments.** The EB-5 visa, developed nearly 25 years ago, creates a pathway for foreign investors to obtain green cards by investing $500,000 and creating 10 or more jobs in economically troubled areas. Today, investments—approximately $1.8 billion in 2012, and with a recent surge in interest[77]—are typically channeled through "regional centers," economic development entities certified by the U.S. Citizenship and Immigration Service (USCIS) to invest EB-5 funds.[78] In the future, USCIS should leverage the existing impact standards already certified and regulated by other agencies. By investing with existing intermediaries—such as community development financial institutions, Small Business Investment Companies, and other proven US-focused impact investment vehicles—EB-5 investors could channel job creation efforts to communities that need it most, all the while supporting organizations that create positive social or environmental impact.

- **Streamline access to development finance.** Development finance tools in the United States are spread across a variety of agencies, each with its own priorities, policies, and regulations. This presents challenges for impact-oriented organizations to access capital. To create efficiencies and develop a unified approach to promoting global development finance, the United States should act on the Global Development Council's April 2014 proposal to create a "one-stop storefront" by formally combining relevant programs at OPIC, USAID, the US Trade and Development Agency, the State Department, and the Treasury's Office of Technical Assistance.[79] This new US Development Finance Bank would draw upon OPIC's capital base, with grant making and technical assistance activities being sustainably self-financed through the retention of OPIC profits. The new organization would also serve as the central platform for project sponsors and investors to readily identify the full range of financing options—helping entrepreneurs to grow—including how to obtain local currency financing and guarantees.

DEVELOP NEW TOOLS TO IMPROVE EFFECTIVENESS

Paying for success means delivering better outcomes and improving the effectiveness of government funds. (For additional detail, see page 10.) Ultimately, pay-for-success arrangements expand the value of government dollars. With that in mind, we recommend that Congress and relevant agencies:

- **Approve the Treasury's Pay-for-Success Fund.** Congress should capitalize the $300 million pay-for-success fund proposed in President Obama's budget and in draft legislation in the House.[80] The fund is designed to provide incentives for state and local governments to develop pay-for-success projects. One key challenge facing these models is risk management. States could agree to a deal, but then not pay investors at the deal's successful end. Massachusetts addressed this issue by establishing a Social Innovation Financing Trust that ensures investors get paid if a deal produces desired results—even if the state's priorities change.[81,82]

In addition, the fund could be used to help solve "wrong pocket" problems—problems that occur when one agency takes risk while another reaps rewards. For example, when the Department of Transportation funds an initiative to reduce obesity, and subsequent cost savings accrue to Health and Human Services without a way for Transportation to be reimbursed for its initial investment. The fund could develop a structure for sharing the cost savings of pay-for-success contracts between federal and state or local budgets ("vertically") or across agencies ("horizontally").

- **Experiment with Development Impact Bonds.** Development impact bonds (DIBs), like social impact bonds, are a method of transferring performance risk for development projects to the private sector and forming more effective partnerships to solve social problems. In a DIB, private investors provide up-front project capital, and donors—rather than country governments—pay if it succeeds in meeting a previously agreed-upon outcome (that is independently and transparently monitored). Internationally, US donor agencies should lead a proposed G7 initiative committing each member country to piloting DIBs focused on social and development objectives. The core elements should include: paying only for successful outcomes, applying rigorous evaluations of program implementation and results, and publishing lessons learned to encourage knowledge dissemination and best practices. Among other things, the latter should include information on DIBs' payout amounts and timing, and what their success and failure rates have been. One concrete approach, which would generate operational efficiencies, is to pool capital with other G7 countries to create a $100 million DIB Outcomes Fund, to which developing countries could submit proposals and compete for funds.

LOOKING FORWARD: TEST SUPPORTIVE PROCUREMENT POLICIES

The US federal government is the world's largest buyer of goods and services. In FY 2013, it awarded $460 billion in contracts to private enterprises, of which $83 billion went to small businesses.[83] To further their own impact investing goals, federal agencies should be allowed to evaluate contractors for social impact. The ultimate success of such targeting should be closely tied to progress in impact measurement (see "metrics and data," page 38). As social impact approaches are piloted, agencies should consider:

- **Experiment with impact-oriented procurement.** Today, some agency procurement policies support environmentally sustainable or minority- or women-owned businesses.[84] Building on these programs, agencies could launch pilot procurement programs that explicitly preference contractors with positive social or environmental impact.

3 PROVIDE INCENTIVES FOR NEW PRIVATE IMPACT INVESTMENT

Impact investing is a framework unifying diverse actors. While many impact investments occur in mature markets, others seek to prove and stimulate new markets. Such deals may initially be smaller, riskier, and more difficult to evaluate relative to traditional markets.[85]

Small investments or time-limited tax incentives from the government, subtly shifting the risk-return balance, can attract a significant influx of private capital and help to jumpstart sustainable markets. To bring investors into this nascent practice, US agencies can deploy funds for credit enhancements, reducing (but not eliminating) investors' risk of a loan default. Agencies can also help to develop a strong impact investment pipeline abroad, addressing gaps in emerging markets by supporting early stage entrepreneurs and providing liquidity to the market. These kinds of investments are proven, cost-effective economic development tools.

A well-known example of early-stage government support for impact-oriented organizations is M-Pesa, the Kenyan mobile payment service. Nearly a decade ago, DFID and British telecom company Vodafone each provided £1 million in seed capital to create M-Pesa's technology. In parallel, the Kenyan government created an enabling regulatory and political environment for a pilot program and advanced adequate consumer protections. M-Pesa launched in 2007, and by 2013 it was used by 17 million Kenyans and handled transactions responsible for over 25 percent of the country's GDP, providing access to financial services and facilitating remittances from urban areas into poorer rural ones.[86]
The M-Pesa story of economic benefit resulting from early-stage seed capital and government support is only one approach to leveraging markets. Governments can use a range of financial tools to incent more private capital into impact investing—stimulating deal flow through early-stage grant or risk capital, mitigating risk through partial guarantees or first-loss capital, or supporting investors via tax policy.

INVEST TARGETED GOVERNMENT FUNDS TO LEVERAGE PRIVATE INVESTMENT

Many impact investments are slightly riskier relative to their expected return than typical commercial investments. Relatively small investments of public funds can mitigate this risk, allowing private investors—such as the bank consortium described in "Changing the Stakes of Affordable Housing" (page 17)—to enter the market and effectively use private capital to achieve public goods. Expanding and replicating existing agency loan or guarantee programs—another way of lessening risk—would also help to expand this impact. To bring in new funding, we recommend that federal agencies:

- **Replicate model impact investing programs to stimulate private investment.** A number of agency programs today provide investment and grant capital for economic development projects. Successful models that attract investors to impact investing are being tested today, both domestically and abroad. The Impact Investment Small Business Investment Company (SBIC) Initiative has committed $1 billion in matching capital for fund managers—at no cost to taxpayers—who commit more than 50 percent of the fund to impact investments.[91] OPIC has dedicated $285 million to seed impact investment funds in emerging markets with the intention of drawing $590 million in coinvestment from private sources.[92] The Department of Labor recently repurposed

POLICY IN ACTION: ATTRACTING PRIVATE CAPITAL TO FINANCE CHARTER SCHOOLS.

Charter schools offer an example of how government funds can leverage private investment. Charters do not typically have access to municipal bonds or local tax base revenue to finance their own facilities. Since 2002, however, the Department of Education has helped charter schools obtain school facilities through purchase, lease, renovation, and construction. With credit guarantees totaling $243 million in the decade since the program's inception,[87] the Charter School Credit Enhancement Program has helped nearly 1 out of 10 charter schools nationwide gain access to financing and has leveraged $2.7 billion in private capital.[88,89] Under the program, less than 1 percent of all funds awarded have been lost to default—demonstrating creditworthiness to the market—which will encourage more private lenders to make loans to charter schools without the need for credit enhancement.[90]

$24 million of existing Workforce Innovation Fund money to pilot pay-for-success programs, joined by almost $50 million of state and private capital in the process.[93] As described above, DCA has attracted $1 billion in private investment with an annual budget of just $8 million. USAID's Agribusiness Project provides matching grants to support impact-oriented businesses and nonprofits, mitigating early stage risk for investors focused on innovative clean energy technologies and financing mechanisms, as well as other sectors.[94]

Other agencies should build from these examples to use their current funding pools to encourage private impact investors. For example, the Millennium Challenge Corporation (MCC)—an independent US foreign aid agency—could complement its $7 billion in traditional grant making[95] by further encouraging compact countries to support innovative public-private partnerships. MCC could build on its ongoing efforts to develop impact funds around major infrastructure projects, leveraging private capital to expand the reach of its resources, strengthening country capital markets, and filling capital gaps preventing innovative solutions from achieving scale. Similarly, the Economic Development Administration could redirect a portion of i6 Innovation Challenge funds to support innovation centers that invest in green or impact-oriented organizations, as it did in 2011 with its i6 Green Challenge.

› **Broaden the scope of current federal capital access programs to include nonprofits.** Government loan programs can help small enterprises grow and attract additional capital. Few such programs, however, take into account the blurring distinction between the private and social sectors. The SBA 7(a) loan program, for example, supplies significant amounts of capital to American small businesses to support economic development and job creation. In FY 2012, it issued over 44,000 loan guarantees totaling more than $15 billion.[100] Under current regulations, however, nonprofits—even those with sustainable revenue models—are not eligible to participate.[101] This regulation has the unintended effect of limiting access to capital for enterprises that deliver public goods and services. Through a combination of legislative and regulatory change, agencies such as the SBA, Housing and Urban Development, Education, Energy, and others should modernize financing programs to support high-impact businesses regardless of corporate form.

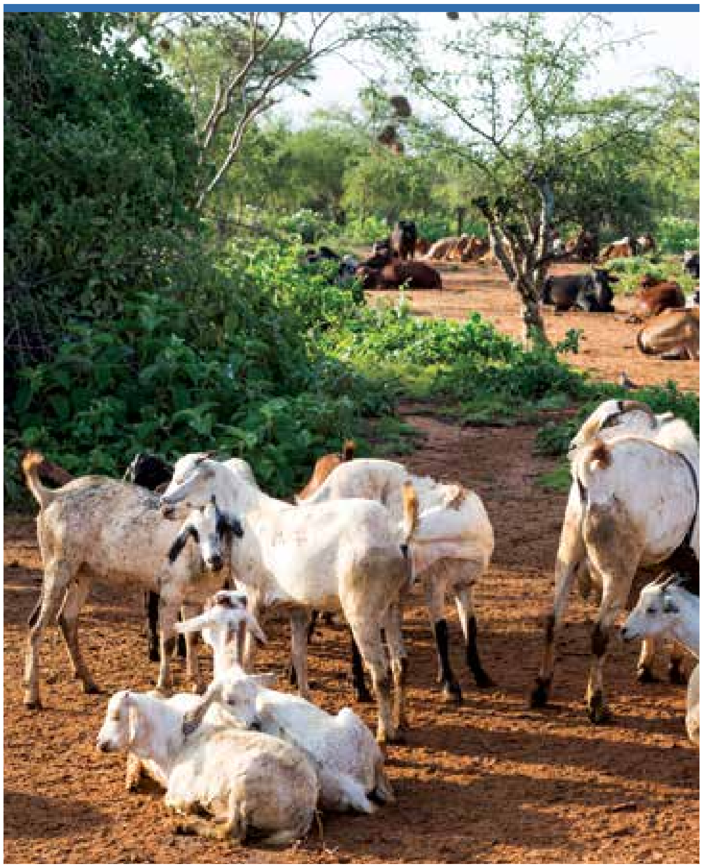
POLICY IN ACTION: FEDERAL COMMUNITY DEVELOPMENT FINANCE PROJECTS ATTRACT PRIVATE CAPITAL.

Major federal programs can produce significant leverage of public funds. The Community Development Finance Institution (CDFI) Fund, established as a part of the Riegle Act of 1994 (see page 35), supports reinvestment in distressed communities across the country. Since its creation, the fund has awarded over $1.1 billion to CDFIs across the country, helping to bring capital, credit, and financial services to low-income communities.[96] The CDFI Bond Guarantee Program provides full guarantees of at least $100 million in bonds, acting as a source of long-term, patient capital to CDFIs.[97] In its first two years, the CDFI Fund's Capital Magnet Fund (CMF) has spent $62 million to generate over $1 billion in affordable housing and associated community and economic development projects. In addition, the National Housing Trust Fund (NHTF) should become an important tool to support the production of affordable rental housing.[98] Signed into law in 2008, the NHTF was supposed to be funded through surplus revenues generated by Fannie Mae and Freddie Mac. Since the federal conservatorship of those organizations, the program has gone unfunded. Recent activity in Congress to support the NHTF has shown promise for capitalizing the program at up to $5 billion a year, with the potential of drawing in significant new sources of private capital.[99]

- **Increase guarantees to mobilize greater US institutional capital for impact investing abroad.** Many US institutional investors have not deployed their capital for global impact investing due to concern about risk and lack of reliable information. OPIC and USAID's Development Credit Authority should explore providing modest, first-lost guarantees for impact investments to the full spectrum of globally oriented investors. This would build off of their track record with other risk mitigation products, such as political risk insurance and partial loan guarantees.

INCREASE USE OF COLLABORATIVE FINANCING VEHICLES

Lack of appropriate capital across the risk/return spectrum is a critical challenge to growth for the impact investment field.[103] This is particularly acute at the early stage of the capital pipeline. Early-stage risk capital can be a smart and sustainable public investment. Once the model has been proven, an impact-oriented organization can grow without additional public support. However, global impact-oriented organizations may face particular difficulties in finding early funding, as many entrepreneurs serving the poor also must overcome challenges, such as poor physical infrastructure and thin pools of skilled labor.[104] Many observers contend that development finance institutions, in particular, have moved away from taking early stage risk due to profit-maximizing objectives and disincentives for staff. Additional research is needed to serve as a call for change for development finance institutions to reevaluate their investment philosophies.



POLICY IN ACTION: ATTRACTING CAPITAL TO AFRICAN FARMS.

Credit enhancements can effectively draw commercial capital to impact investing. In September 2011, USAID's Development Credit Authority signed a 12-year, 50 percent loan guarantee on J.P. Morgan's $8 million debt investment in the African Agriculture Capital Fund (AACF). This capital works alongside $17 million in equity investments from the Bill & Melinda Gates Foundation, the Gatsby Charitable Foundation, and the Rockefeller Foundation. The fund's manager, Pearl Capital Partners—an African agricultural investment fund based in Uganda—will invest in at least 20 agriculture-related businesses in East Africa, from potato growing and processing in Kenya to poultry farming in Uganda.[102]

In response to limited early stage capital, domestic and global agencies could support the development of innovative collaboration models that seek to:

› **Develop multilateral, pooled vehicles to fill gaps in early-stage risk capital.** Agencies should encourage consolidation of mixed investment and grant capital in order to develop a more robust pipeline of startups and entrepreneurs. Domestically, Living Cities' Catalyst Fund serves as an effective example, pooling investment from many of America's largest foundations to improve education, economic development, and health in underserved communities by providing below-market-rate loans and guarantees. One promising international vehicle is the Global Development Innovation Ventures (GDIV), a new early-stage emerging markets investment platform cofounded by USAID and the UK's Department for International Development. It is modeled after the Development Innovation Ventures program at USAID to identify potential solutions to problems inhibiting global development—deploying staged financing to test pilot programs, and then scale up those interventions that prove to be cost effective. GDIV should recruit top private-sector talent with experience in emerging market businesses and seek to maximize coinvestment and follow-on investment from the private sector.

The challenge to finding appropriate growth capital continues as enterprises grow. Funders pursuing different investment approaches face challenges in collaborating. When they do occur, collaborative deals are often conducted ad hoc. The complexities of aligning multiple actors across the philanthropic, development, and private capital sectors can create significant transaction cost and friction. To alleviate these difficulties, US global development agencies could:

- **Encourage integrated public-private grant-investment capital funds for global development.** By developing a standing investment facility, foundations, development finance institutions, and private investors can align the timing and uses of their respective grants and investments. This would provide businesses the right kind of funding at the right stage in their development, as described in a recent OPIC proposal.[105] In the process, such a facility would help to bring in additional private investment. For example, small-grant funding could focus on helping businesses meet global standards and certification, while a mix of debt, equity, and grants can support businesses in gaining scale before being able to take on commercial capital.

LOOKING FORWARD: RESHAPE THE FEDERAL TAX CODE

Government can take direct action to incent private impact investments, helping to build the market during its early stages. While tax reform may be politically challenging, it is important to begin building political will and model language to seize a future opportunity if it presents itself. To that end, Congress could:

- **Review the tax code to target opportunities to support impact investments.** To influence greater participation in the impact investment field, Congress can provide tax incentives that modestly lower corporate tax rates for qualified impact businesses, lower capital gains rates for investors supporting qualified impact businesses, allow impact investors to write off losses as a charitable tax deduction, or allow individuals to deduct contributions to US impact initiatives. Alternatively, Congress could allow tax-advantaged repatriation of record levels of overseas profits to support an impact investing fund in the United States,

POLICY IN ACTION: HISTORICAL IMPACT INVESTING TAX CREDIT PROGRAMS HAVE BEEN TREMENDOUSLY SUCCESSFUL.

For decades, impact investing in the United States has been buoyed by federal tax programs. Key among these programs are:

- The Low-Income Housing Tax Credit (LIHTC), "the most successful affordable rental housing production program in US history."[108] Since 1986, it has been responsible for nearly $100 billion in private investment capital, supporting the development of 2.6 million affordable homes and 95,000 jobs.[109]

- The New Market Tax Credit (NMTC), a cornerstone of support for impact investing by the US government. NMTC attracts private capital to some of the most distressed communities throughout the country. Since its inception in 2000, the Department of the Treasury's CDFI fund has allocated over $36.5 billion in NMTC authority—leveraging $8 in private capital for every $1 invested, and creating over 500,000 jobs in our most distressed areas.[110]

We strongly endorse ongoing efforts to ensure continued support for these critical initiatives, including efforts to make the NMTC permanent.

POLICY IN ACTION: INCUBATING ENVIRONMENTAL ENTREPRENEURSHIP.

Federal programs can support the development of impact-oriented entrepreneurs one sector at a time. In January 2014, the Department of Energy announced a $3 million program, called the National Incubator Initiative for Clean Energy, to support the commercialization of clean energy technologies. The fund will support five incubators to develop clean-energy sector best practices, as well as fund a national organization to coordinate energy-focused clean-energy startups. The program builds on a strong precedent in the energy arena: the SunShot Incubator Program has funded 58 startups with $104 million since 2007 and has amassed more than $1.7 billion in private venture capital and private equity investment.[112]

building from a series of related congressional proposals enjoying bipartisan support.[106] In the event of such a bill's passage, Congress should consider leveraging existing federally regulated impact investment programs (such as CDFIs) as mechanisms for deployment. Each of these policy ideas will require further research to identify their full effects, determine appropriate tax rates, and resolve key implementation questions[107]—particularly the ability to properly identify and catalogue covered impact investments. Tax reform policies would build on progress outlined in the "metrics and data" section of this report (see page 38), but would require organizations to achieve a higher standard of classification, accreditation, auditing, or legal requirements to receive these benefits.

SUPPORTING POLICY AREA: ENCOURAGE AND SUPPORT INNOVATIVE IMPACT-ORIENTED ORGANIZATIONS AND IMPACT INVESTMENT OPPORTUNITIES

Impact investors consistently cite a lack of investment-ready deals suitable for deploying their capital. Indeed, in the 2014 impact investor survey from J.P. Morgan and the Global Impact Investing Network (GIIN), investors identified "shortage of high-quality investment opportunities with track record" as the most limiting characteristic of the market today.[111] More must be done to increase entrepreneurial capacity, streamline and reduce transaction costs, and mainstream entrepreneurial interest in socially oriented businesses. Doing so will decrease the financial and organizational burdens placed on these enterprises, allowing them the opportunity to focus on their work rather than on investor red tape.

However, many of these changes will be led by the private sector. In support of developing more and higher-quality entrepreneurs and organizations, the federal government could:

- **Use the influence of Congress, the White House, and federal agencies to celebrate impact-oriented entrepreneurs and businesses.** Shining the federal spotlight on successful impact-oriented organizations is a low-cost and powerful way to challenge entrepreneurs, raise the profile of impact investing within policy circles, inspire participation from high-net-worth individuals, and to encourage agency employees to innovate. One component of this idea could be to offer an annual award, gathering like-minded entrepreneurs, nonprofits, businesses, and impact investors from within and beyond the government to highlight the benefits provided by impact investments both at home and abroad.

Another way to resolve the mismatch between supply of impact investment capital and investable opportunities is direct capacity-building efforts, both at home and abroad. These efforts can build critical institutional infrastructure for impact investing.

- **Support the growth and development of field-building intermediaries**. Great companies are not built without help, and government can play a role in facilitating the growth of an enabling entrepreneurial ecosystem. Domestically, additional agencies can follow the example of HUD Section 4 grants that flow to intermediaries such as Enterprise and LISC, who then re-grant to organizations to enhance their capacity.[113] Similarly global development agencies and international finance institutions could develop partnerships with field-building organizations that support impact-oriented organizations. For example, USAID's Partnering to Accelerate Entrepreneurship (PACE) Initiative invests up to $10 million to test scalable models for accelerating early enterprises by supporting incubators, accelerators, investors, and others. Another USAID program, the Higher Education Solutions Network (HESN), matches $25 million grants against university funds to create Development Labs which evaluate and strengthen development innovations. Field-building organizations, such as the Global Impact Investing Network (GIIN)[114] and the Global Entrepreneurship Research Network (GERN),[115] can help to spread education, build databases that will allow more in-depth research on successful and unsuccessful transactions and incubation methods, and promote a better understanding of policy barriers.

SUPPORTING POLICY AREA: STANDARDIZE METRICS AND IMPROVE DATA ACCESS

To make fully informed decisions, impact investors need clear metrics to compare the impacts (both social and financial) of different businesses.

Tools for measuring financial performance are well developed, but tools for measuring social and environmental impact are nascent. The private and nonprofit sectors are working to build consensus around which social impact metrics matter, and how to best measure performance via third-party ratings and accreditation. The federal government can use its influence to accelerate the process of reaching consensus first by endorsing a set of guidelines about what constitutes a rigorous standard, and second by adopting metrics developed by the private and nonprofit sectors to evaluate agency procurement and investment policy (see “test supportive procurement policies” on page 30).

Investors also need more and better data about the performance of impact investments. More data will help to establish the risk and return of a breadth of impact investments—reducing barriers for new investors, and enabling current investors (including government agencies themselves) to accomplish more with their investments. To this end, federal agencies should consistently include impact analysis as a part of their deal selection and diligence processes, attempt where appropriate to measure the economic savings generated via social interventions, and make their impact and return data easily accessible and well organized to promote rigorous analysis.

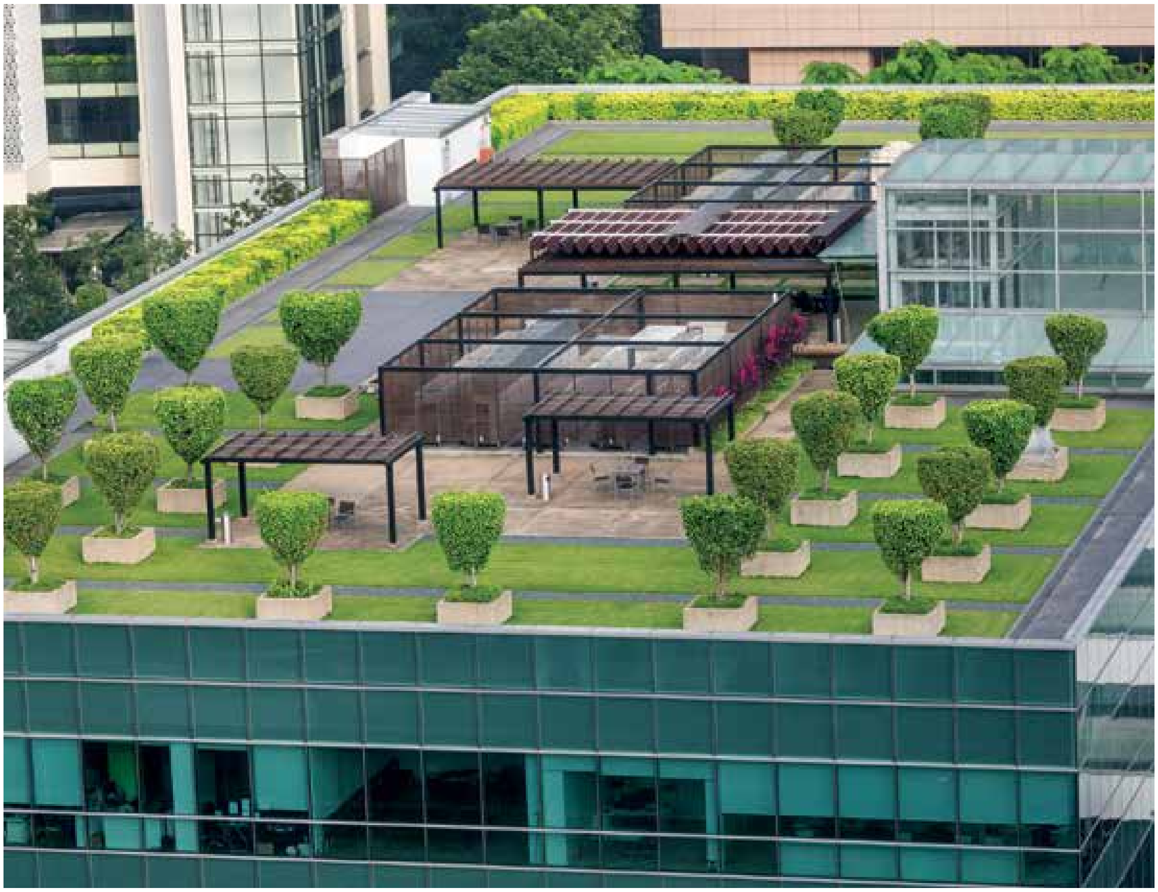
PURSUE AGENCY ENDORSEMENT OF STANDARDS FOR IMPACT METRICS

Investors need a unified set of metrics by which to measure the social impact of their capital. However, it is important to allow industry to coalesce around these metrics unimpeded by direct government intervention. US government agencies can play a supporting role. We recommend that they:

- **Endorse a framework for more robust impact measurement and standards.** The Office of Social Innovation should endorse the framework under development by the Global Task Force on Impact Investment established by the G8, which seeks to clarify the key elements of a robust impact measurement system—encouraging transparency, cocreation, and comprehensiveness. In turn, relevant US agencies should apply this framework to their respective impact measurement initiatives.

IDENTIFY AREAS TO OPEN ACCESS TO AGENCY IMPACT AND RETURN DATA

US government agencies collect enormous amounts of information that would be useful to investors and researchers. For decades, development finance institutions and other agencies have developed rigorous definitions and collected impact data. However, there has been little sharing of these data; when information is shared, it is sometimes poorly organized or difficult to understand. In concert with the private sector and nonprofits, agencies should work to identify where key data sources exist and create solutions for increasing their accessibility. They should attempt to:



POLICY IN ACTION: FOLLOWING THE INDUSTRY'S LEED.

In 2007, the federal government set forward an ambitious set of energy savings and sustainability goals for its own facilities as part of the Energy Independence and Security Act (EISA). To achieve these goals, the nation's biggest landlord, the General Services Administration, turned to the experts on green buildings and construction: Leadership in Energy and Environmental Design (LEED).[116] LEED provides a third-party rating system grounded in industry expertise. In the last decade, dozens of cities and counties, from Gainesville, Florida, to Seattle, Washington, and from Howard County, Maryland, to Harris County, Texas,[117] have implemented incentive programs (such as tax credits, low-interest loans, and permitting priority) to support LEED-rated buildings.[118] The ratings are developed and administered by the members of the US Green Business Council, a large and diverse coalition of building industry leaders, and the General Services Administration reports that LEED continues to help government achieve its energy and sustainability goals while saving money.[119] As the impact investing space matures, independent third-party certifications and accreditations—similar to LEED standards—have begun to form.

- **Replicate innovative data-sharing efforts. The sharing of government data is often hampered by confidentiality constraints.** Agencies should pursue approaches that respect these important proprietary, competitive, and legal constraints but seek to:

  - *Increase sharing*—US agencies and development finance institutions should seek to publish the maximum amount of transaction-level data possible. In places where sharing at this level is sensitive, programs with significant caches of data should identify methods of sharing in aggregate, as long as doing so protects proprietary information. For example, USAID could aggregate data on the various entrepreneurship and impact investing programs currently being implemented (such as DIV, Grand Challenges for Development, Feed the Future, PACE) and make those data available in a searchable format. OPIC could publish a core set of transaction-level impact data, including financial returns, along with aggregated country-level and sector-level data in instances where confidentiality constraints may be an issue. And the Department of Health and Human Services might publish aggregated outcome tracking data from Affordable Care Act reforms in order to support creation of pay-for-success instruments.

  - *Build the evidence base around unit costs*—Modeling efforts off of an analogous UK project, the United States could begin an interagency effort to create a shared understanding of the cost effectiveness of social interventions by developing a unit-cost database. Such a database would house the government's collective knowledge on cost estimates of crime, education and skills, employment and economy, fire, health, housing, social services, and more, helping to frame the value of pay-for-success proposals and other impact investments.

  - *Promote opt-in solutions*—Some programs have created mechanisms designed to overcome constraints on sharing confidential transaction-level detail. The Department of Education's i3 Fund, for example, enables applicants to opt-in to allowing private philanthropists to review and coinvest in their applications. Through a joint platform, development finance organizations and multilaterals could replicate this system to allow organizations to opt-in for shared due diligence.

CONCLUSION

Today, we have the opportunity to help cultivate an important set of innovations at the intersection of private capital and public good. The tools of impact investing can help scale innovative solutions to our most pressing problems. Government can supercharge impact investing by reducing bureaucratic barriers and providing incentives for public-private partnerships.

Innovation is in our American DNA, and US policy has a long tradition of supporting that innovation which contributes to our global competitiveness. This support reaches into nearly every industry. Last year, President Obama's budget request included over $140 billion for research and development, stimulating industries from biotechnology to robotics. At the same time, the government is deeply engaged in the process of economic development—from supporting entrepreneurs and small businesses (e.g., through the Small Business Administration) to providing grants to distressed communities (e.g., via the Economic Development Administration). Our entrepreneurs and investors drive economic growth, and the US government provides an important source of support for those efforts.

The recommendations in this report provide a path forward. The federal government, working with Congress, should revise rules that are inhibiting the flow of new capital toward investments that create both positive financial and social outcomes. It should also partner with the movement where possible, helping to promote impact-oriented entrepreneurs and to encourage an efficient marketplace of disciplined investors making data-driven decisions.

These strategies can help to unleash American innovation and entrepreneurial activity equal to the challenges we face. It is time for us to create partnerships that can unlock new sources of economic and social value for US corporations, small businesses, communities, and families. Neither government nor philanthropy alone can solve our nation's biggest problems. Impact investing can help—but only if it is able to reach sufficient scale. Policy can help to remove barriers blocking this market's progress and to recast the role of financial markets in our society, harnessing their power to serve a higher purpose: to promote new solutions that bring the effectiveness of the market to bear on our most important public concerns.

APPENDIX I:

Overview of Social Impact Investing Task Force and National Advisory Board Process

Background. Ahead of the 2013 G8 meeting, the UK government hosted a Social Impact Investing Forum, under the chairmanship of Sir Ronald Cohen. The forum convened more than 100 thought leaders from around the world, including G8 member states, to discuss the state of the global market. This group of policymakers, private investors, and social entrepreneurs explored the possibilities for impact investing to accelerate economic growth and to promote the public interest in industrialized as well as developing countries.

Based on the success of the meeting, the UK launched a Social Impact Investing Task Force (SIITF) to promote policy changes and private sector action on several fronts: working with the OECD to assess the size of the global market, harmonizing impact metrics across borders, and exploring how to increase the use of impact investing in a development context. The Task Force includes two representatives from each of the G8 countries as well as the European Union nations, and will convene six times through October 2014.

The US National Advisory Board. To support the US delegation, the US National Advisory Board (NAB) was appointed to formulate a US-focused impact investing policy agenda. Over several months, the NAB developed a set of guiding principles for agenda-setting and highlighted key initiatives for US policymakers.

Membership. The NAB is comprised of 27 thought leaders in US impact investing, spanning the sector and including private investors, foundations, academics, impact-oriented organizations, nonprofits, and intermediaries. Matt Bannick, Managing Partner of Omidyar Network, and Tracy Palandjian, CEO of Social Finance US, serve as the board's cochairs.

Policy development process. The NAB kicked off its work with a meeting in September 2013 in which it split into five topic focus groups: Mainstreaming Impact Investing, Strengthening Nonprofit Capital Markets, International Development, Impact Measurement, and Communications and Engagement. Using surveys, focus group meetings, and individual interviews facilitated by The Bridgespan Group—and supplemented by extensive secondary research and engagement with other groups, such as the Accelerating Impact Investing Initiative (AI3)—NAB members worked to develop a list of over 70 policy ideas with the potential to accelerate the market.[120] (Please see Appendix VI for a representative sample of this broader set of policies). These policies were further segmented by how they could be enacted (e.g., via legislation, executive action, regulatory change, or influence strategies) and which actors they would affect (e.g., investors, intermediaries, or impact-oriented organizations). Some were meant to be both highly actionable, near-term ideas, whereas others were broader, more far-reaching concepts.

In discussions regarding the expected impact and feasibility of these policies, a shorter list was prioritized and discussed in detail during in-person meetings in Washington, D.C., in February and April, via follow-up conference calls, and through multiple rounds of detailed written feedback.

These policies, taken as a whole, were intended to be:

- **ambitious,** with the ability to create significant changes in the impact investing field,
- **inclusive,** supporting the evolving culture and set of practices of impact-oriented investment professionals, institutional fiduciaries, foundations, and mission-driven nonprofits; and endorsing the diversity of approaches within impact investing's "big tent,"
- **broad-based**, garnering wide support from across sectors and political orientations, rather than narrowly tailored to a given industry or ideology, and
- **actionable**, defining the potential steps to be taken by policymakers to enable effective solutions to our most pressing and longstanding problems.

In these meetings, members further articulated a set of overarching strategies that united these policies. This report is structured around those strategies.

This report is the result of an in-depth, collaborative effort of the NAB members. They were deeply involved in the policy strategies and recommendations as well as the selection of case studies. The report benefited enormously from the diversity of expertise and opinion that NAB members as a group brought to the task. As individuals and as a group, NAB members hosted opportunities of consultation, advocacy, and engagement with hundreds of stakeholders working to build the field of impact investing and entrepreneurship.

APPENDIX II:

US National Advisory Board Membership List

Matt Bannick (cochair)	*Omidyar Network*
Antony Bugg-Levine	*Nonprofit Finance Fund*
Jean Case	*The Case Foundation*
David Chen	*Equilibrium Capital*
Audrey Choi	*Morgan Stanley*
Maya Chorengel	*Elevar Equity*
Cathy Clark	*Duke University*
Kimberlee Cornett	*Kresge Foundation*
William Foster	*The Bridgespan Group*
Seth Goldman	*Honest Tea*
John Goldstein	*Imprint Capital*
Josh Gotbaum	*Pension Benefit Guaranty Corp*
Michelle Greene	*NYSE Euronext*
Sean Greene	*Revolution*
Ben Hecht	*Living Cities*
Andrew Kassoy	*B Lab*
Zia Khan	*The Rockefeller Foundation*
Clara Miller	*F.B. Heron Foundation*
Elizabeth Littlefield	*OPIC*
Tracy Palandjian (cochair)	*Social Finance*
Stewart Paperin	*Soros Economic Development Fund*
Andrea Phillips	*Goldman Sachs*
Luther Ragin	*Global Impact Investing Network*
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All advisors serve as individuals, imparting personal and professional expertise. The organizations listed alongside NAB advisors are for identification purposes only.

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APPENDIX IV:

National Advisory Board Team

Secretariat:

Omidyar Network hosted a secretariat that managed the strategic and day-to-day activities of the National Advisory Board and supported US representation to the Global Social Impact Investing Task Force. Paula Goldman served as executive, Rosita Najmi served as manager, and team members included Lauren Booker and Kelsey King.

Communications and Engagement:

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All errors and omissions are ours alone.

APPENDIX V:

Contributors

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- Global Impact Investing Network (GIIN)
- Impact Capitalism Summit
- Milken Conference
- Mission Investors Exchange
- NYSE
- Orrick Impact Finance
- RFK Compass
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David Houlihan	McDonough School of Business
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Michael McLaughlin	McDonough School of Business
Matthew Michel	Enclude
Ted Moran	Center for Global Development
Will Morgan	Sonen Capital
Robert Mosbacher	BizCorps, Inc.
Anne Mosle	The Aspen Institute
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Cynthia Muller	Arabella Advisors
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Mark Newberg	5 Stone Green Capital
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Jenna Nicholas	Phoenix Global Impact
Alex Nicholls	University of Oxford
Bill Novelli	McDonough School of Business Global Social Enterprise Initiative
Maura O'Neill	University of California, Berkeley
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Shelly Porges	Ready for Hillary
Ben Powell	Agora Partnerships
Gerhard Pries	Sarona
Cliff Prior	UnLtd
Julia Rebholz	Centrica
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Megan Smith	US SIF
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APPENDIX VI:

Additional policies considered

Below are additional policy ideas derived from the extensive outreach and engagement process undertaken by the National Advisory Board in developing this report. They are not specifically endorsed by the board, but reflect policy changes recommended by experienced impact investing practitioners in each of the subject areas addressed.

REMOVE BARRIERS TO UNLOCK ADDITIONAL PRIVATE IMPACT INVESTMENT

- **Further clarify that impact investing is compatible with fiduciary duty,** providing SEC guidance about the role of registered investment advisors in recommending and supporting impact investments, releasing an SEC clarification letter delineating that employees may allocate 401(k) investments in qualified impact investments, creating a safe-harbor provision under ERISA for impact investments, or ensuring that impact investments clearly fit under professional indemnity insurance plans.

- **Supporting foundation efforts to make impact investments** by raising awareness and understanding of impact investing tools and structures (for example, through use of Program-Related Investments (PRIs) and Donor Advised Funds), creating incentives for Donor Advised Funds to invest in PRIs, mandating a percentage of foundation endowments be allocated to impact investing, or by increasing foundation payout requirement but allowing increased eligibility for impact investments.

- **Use the influence of Congress, the White House, and agencies to increase the profile of impact investing**, by mentioning impact investing in the State of the Union, encouraging major financial services companies to further support impact investing, or identifying, disseminating, and supporting best practices via government-funded research and reports.

- **Cultivate talent** by developing a fellowship program to match mid-career venture capital investors with impact investment funds.

INCREASE THE EFFECTIVENESS OF GOVERNMENT PROGRAMS

- **Promote flexibility of government funds to support innovative impact investing tools, such as social impact bonds (SIBs),** by issuing an executive order authorizing agencies to use SIBs, clarifying federal administrative rules and regulations related to federal block grants to enable state- and municipal-led pay-for-success deals, or researching key priority areas and economic rationale for pay-for-success models.

- **Expand the federal Social Innovation Fund to include debt as well as grants**, creating the US equivalent of the UK's Big Society Capital.

- **Create an exemption in the Paperwork Reduction Act** for US agencies (e.g., OPIC, SBA) to ask for impact reporting without requalification.

PROVIDE INCENTIVES FOR NEW PRIVATE IMPACT INVESTMENT

- **Broaden banks' ability to invest Community Reinvestment Act funds** in new types of impact investing deals (i.e., beyond community development, housing finance, etc.).

- **Expand the New Markets Tax Credit program**, for example, by launching a new Impact Communities Tax Credit modeled after the Manufacturing Communities Tax Credit.

- **Issue federal partial guarantees for state-led SIBs** in case a change in administrations leads to a failure to fulfill payment obligations.

- **Create more financial products for impact investing** (e.g., Social Impact T-bills, Dutch grant-to-equity model, new funding mechanisms for DFIs).

ENCOURAGE AND SUPPORT INNOVATIVE IMPACT-ORIENTED ORGANIZATIONS AND IMPACT INVESTMENT OPPORTUNITIES

- **Expand the reach of technical support, mentorship, and capital access networks** (e.g., CDFIs, Micro-Lenders, SBDCs, MEPs, Rural Extension Centers, Regional Innovation Clusters and accelerators) and provide technical assistance grants alongside agency debt and equity investments.

- **Create a mentorship program** that pairs a for-profit entrepreneur with a social entrepreneur.

- **Propose model process for SIB legislation** (e.g., make the contracting process public, create legislative templates).

- **Identify, disseminate, and support best ways for impact-oriented organizations to scale** (e.g., sector-based approaches) via government-funded research and reports.

STANDARDIZE METRICS AND IMPROVE DATA ACCESS

- **Increase impact disclosure requirements for private companies**, mandating impact reporting for all businesses working with the federal government, requiring financial institutions to report impact of CRA and/or NMTC investments, or supporting the development of SEC/CFTC/CFPB rules governing collection and disclosure of impact data by public corporations.

- **Increase disclosure of financial alignment of foundations**, revising the 990 form to include self-reporting on percent of endowment invested in activities aligned with mission.

- **Take the lead on developing metrics**, creating ratings and certification agencies to provide objective third-party impact evaluations, codifying and endorsing what qualifies as an impact investment.

NOTES:

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[24] Jessica Freireich and Katherine Fulton, *Investing for Social and Environmental Impact* (Monitor Institute, 2009).

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[59] "Fiduciaries who rely on factors outside the economic interests of the plan in making investment choices and subsequently find their decision challenged will rarely be able to demonstrate compliance with ERISA absent a written record demonstrating that a contemporaneous economic analysis showed that the investment alternatives were of equal value." Supplemental guidance relating to fiduciary responsibility in considering economically

targeted investments. 73 Fed. Reg. 61, 735 (Oct. 17, 2008)

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61 MRIs have had limited traction to date, driven in large part by divisions in organizational structures, skill-sets, and incentives between investors who focus on social returns from those who focus on financial returns.

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63 http://www.gatesfoundation.org/Media-Center/Press-Releases/2009/12/Root-Capital-Recipient-of-First-Agricultural-Development-PRI

64 investments that show a lack of reasonable business care and prudence in providing for the long- and short-term financial needs of the foundation for it to carry out its exempt function.

65 http://www.doingbusiness.org/rankings

66 OPIC's multibillion-dollar annual budget is served by fewer than 200 employees.

67 http://www.fas.org/sgp/crs/misc/98-567.pdf

68 Since 2007, OPIC has reauthorized annually, where it was previously authorized on a five-year basis.

69 Projects today must "have a meaningful connection to the U.S. private sector." This is defined as "a U.S.-organized entity 25 percent or more U.S.-owned or a majority U.S.-owned foreign-organized entity; U.S. citizens, lawful permanent residents and U.S.-organized non-governmental organizations." OPIC, FAQs, <http://www.opic.gov/media-connections/faqs>

70 http://www.usaid.gov/news-information/press-releases/nov-6-2013-usaids-new-approach-unlocks-1-billion-private-financing-development

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72 http://www.greatcommunities.org/wp-content/uploads/pdf/TOAH_report.pdf

73 http://www.mtc.ca.gov/news/press_releases/rel523.htm

74 http://portal.hud.gov/hudportal/documents/huddoc?id=5696-n-06_cdbg-frnotice.pdf

75 http://www.housingpartnership.net/documents/policy_paper_web.pdf#page=10

76 Generally, an account is considered unclaimed or dormant when there has been no customer activity for some time between three to five years. Once assets have been deemed "unclaimed" and the bank cannot reach the customer, the bank turns the assets over to the state.

77 https://iiusa.org/blog/research-analysis/purchase-iiusacommissioned-2012-economic-impacts-report-eb5-industrys-definitive-economic-report-date/

78 Requirements for EB-5 visas include: investment of $1M, or $0.5M in "Targeted Employment Areas," defined as rural (outside of an OMB-defined metropolitan statistical area [MSA]) or within an MSA experiencing unemployment of 150% above the national average. This investment must be show to create 10 jobs, either directly within a commercial enterprise or indirectly via an approved "regional center," defined as "any economic entity, public or private, which is involved with the promotion of economic growth, improved regional productivity, job creation and increased domestic capital investment." U.S. Citizenship and Immigration Services, EB-5 Immigrant Investor, http://www.uscis.gov/working-united-states/permanent-workers/employment-based-immigration-fifth-preference-eb-5/eb-5-immigrant-investor.

79 http://www.whitehouse.gov/sites/default/files/docs/gdc_memo_for_the_president_final.pdf

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82 National Archives and Records Administration. "Federal Register: Strategies to Accelerate the Testing and Adoption of Pay for Success (PFS) Financing Models." Accessed March 4, 2014. https://www.federalregister.gov/

articles/2013/10/02/2013-24078/strategies-to-accelerate-the-testing-and-adoption-of-pay-for-success-pfs-financing-models#h-13.

[83] http://www.nytimes.com/2014/01/16/business/federal-contracts-plunge-squeezing-private-companies.html

[84] e.g., EPA's Environmentally Preferable Purchasing program, Commerce's Minority Business Development Agency Federal Procurement Center, and SBA's Women-Owned Small Business program

[85] Average deal size $2M compared to $36M for PE growth capital deals

[86] http://www.economist.com/blogs/economist-explains/2013/05/economist-explains-18

[87] http://www2.ed.gov/programs/charterfacilities/index.html

[88] http://www2.ed.gov/programs/charterfacilities/performance.html

[89] http://www.iff.org/charter-school-credit-enhancement-program

[90] http://www2.ed.gov/programs/charterfacilities/performance.html

[91] U.S. Small Business Administration. "Overview: Impact Investment SBIC Initiative." Accessed March 4, 2014. http://www.sba.gov/content/overview-impact-investment-sbic-initiative.

[92] The Investment Fund for Health in Africa II (healthcare): $83M; Latin Idea Ventures (technology, media, and telecommunications): $25M; Manocap (SMEs in West Africa): $34M; MPower Ventures (financial inclusion in Latin America): $15M; Sarona (fund of private equity funds investing in SMEs): $87.5M; Terra Bella (carbon credits and environmental protection) : $40M; Source: OPIC. "In Historic Commitment to Impact Investing, OPIC Board Approves $285 Million for Six Funds Catalyzing $875 Million in Investments." Accessed March 4, 2014. http://www.opic.gov/press-releases/2011/historic-commitment-impact-investing-opic-board-approves-285-million-six-funds-c.

[93] http://www.dol.gov/opa/media/press/eta/ETA20131936.htm

[94] http://www.agribusiness.org.pk/node/19

[95] https://www.mcc.gov/pages/about; https://www.mcc.gov/documents/reports/report-fy2014-cbj.pdf

[96] http://www.enterprisecommunity.com/policy-and-advocacy/issues/community-development-finance-and-regulation/community-development-financial-institutions-fund

[97] http://www.cdfifund.gov/what_we_do/programs_id.asp?programID=14

[98] http://nlihc.org/issues/nhtf

[99] http://reversemortgagedaily.com/2014/02/04/hud-secretary-wants-5-billion-affordable-housing-trust-fund/

[100] U.S. Small Business Administration. "SBA Loan Dollars in FY 2012 Reach Second Largest Total Ever; $30.25 Billion Second Only to FY 2011." Accessed March 4, 2014. http://www.sba.gov/content/sba-loan-dollars-fy-2012-reach-second-largest-total-ever-3025-billion-second-only-fy-2011.

[101] U.S. Small Business Administration. "7(a) Loan Program Eligibiliy." Accessed March 4, 2014. http://www.sba.gov/content/7a-loan-program-eligibility.

[102] http://www.thegiin.org/binary-data/RESOURCE/download_file/000/000/424-1.pdf

[103] JP Morgan and GIIN, Spotlight on the Market, 2014: page 5.

[104] http://www.ssireview.org/articles/entry/closing_the_pioneer_gap

[105] http://www.brookings.edu/~/media/research/files/reports/2013/09/private%20sector%20global%20poverty%20blum%20roundtable/2013%20bbr%20capital%20alignment.pdf

[106] http://www.washingtonpost.com/opinions/improving-us-infrastructure-starts-with-tax-reform/2014/05/02/97c3769c-cbc7-11e3-95f7-7ecdde72d2ea_story.html?wpisrc=emailtoafriend

[107] For instance, the tax incentives could come in the form of "impact economy tax brackets" tied to performance (e.g., by hitting more challenging social impact targets, social enterprises lower their tax rates), a flat rate applied to all qualifying impact-oriented organizations (e.g., B Corps, L3Cs, etc.), or other vehicles..

[108] National Association of Home Builders, “The Low Income Housing Tax Credit,” <http://www.nahb.org/fileUpload_details.aspx?contentID=151606>

[109] Enterprise Community Partners, “Low-Income Housing Tax Credit,” <http://www.enterprisecommunity.com/low-income-housing-tax-credits-policy>

[110] http://www.enterprisecommunity.com/servlet/servlet.FileDownload?file=00Pa000000Mns7zEAB

[111] JP Morgan and GIIN, Spotlight on the Market, 2014: page 5.

[112] http://energy.gov/eere/sunshot/sunshot-incubator-program. Increasingly, a network of supports exists to prepare businesses for growth. Incubators typically offer work space, training in basic business skills, and access to financing and professional networks; they may last for a year or more. Accelerators help businesses prepare for rapid growth, sorting out organizational, operational, and strategic difficulties over the course of an intensive ~3-6 month program. Increasingly, new incubators and accelerators are dedicated to impact-oriented businesses, such as Santa Clara University’s Global Social Benefit Incubator, Philadelphia’s GoodCompany, and San Francisco’s Hub Ventures. http://cleantechnica.com/2014/01/08/does-3-million-clean-energy-incubator-funding-is-very-niice/

[113] http://community-wealth.org/strategies/policy-guide/hud_section-4.html

[114] http://www.standardnewswire.com/news/619324565.html

[115] http://www.kauffman.org/what-we-do/programs/entrepreneurship/global-entrepreneurship-research-network

[116] http://www.gsa.gov/portal/category/25999

[117] http://www.usgbc.org/Docs/Archive/General/Docs2021.pdf

[118] Jennie Richards, “Green Building: A Retrospective on the History of LEED Certification,” Institute for Environmental Entrepreneurship <http://envirоinstitute.org/wp-content/uploads/2012/09/GREEN-BUILDING-A-Retrospective-History-of-LEED-Certification-November-2012.pdf >. Georgia Tech Procurement Assistance Center, “GSA issues recommendation for ‘green’ building certification,” November 2013 <http://gtpac.org/2013/11/gsa-issues-recommendation-for-green-building-certification>

[119] http://www.usgbc.org/articles/once-again-gsa-recognizes-leed-works

[120] See Appendix IV.

[121] http://www.pacificcommunityventures.org/uploads/reports-and-publications/US_Ecosystem_Final_2014_04_24.pdf

NOTES:

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Social Impact Investment

BUILDING THE EVIDENCE BASE

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FOREWORD

New and innovative approaches are needed for addressing social and economic challenges. Social impact investment has become increasingly relevant in today's economic setting as social challenges have mounted while public funds in many countries are under pressure. This report provides a framework for assessing the social impact investment market and focuses on the need to build the evidence base. The report highlights the importance of further international collaborations in developing global standards on definitions, data collection, impact measurement and evaluation of policies. In a fast evolving new area, experience sharing between players in the market is also vital. International organisations, such as the OECD can play an important role in facilitating these collaborations as well as conducting further analysis and data collection.

The project has been managed by Karen Wilson, consultant in the Structural Policy Division of the Directorate for Science, Technology and Innovation at the OECD. The report was written by Karen Wilson, Filipe Silva, Junior Policy Analyst in the Structural Policy Division of the Directorate for Science, Technology and Innovation and Dominic Richardson, Policy Analyst, Directorate for Employment, Labour and Social Affairs.

Social impact investment has become a growing area of interest within the OECD, linking to two strategic OECD initiatives, New Approaches to Economic Challenges (NAEC) and Inclusive Growth as well as ongoing work across a number of Directorates.

The OECD Committee for Industry, Innovation and Entrepreneurship (CIIE) agreed to the declassification of this report in January 2015.

ACKNOWLEDGEMENTS

The OECD is grateful to the Department of Employment and Social Development in Canada, the U.K. Cabinet Office, and the Bertelsmann Foundation for their support of this work.

In addition, the OECD would like to thank the Social Impact Investment Taskforce, established by the G8 during the UK Presidency, for their input throughout the process. A particular acknowledgement is extended to the Chair of the Taskforce, Sir Ronald Cohen, for his leadership, vision and drive in catalysing a global movement to build the social impact investment market.

The authors would like to thank the many experts who contributed to this work including all of the members of the Social Impact Investment Taskforce, their colleagues and others serving on the Working Groups and National Advisory Boards.

During the course of the project, the OECD held two Social Impact Investment Expert Group meetings and would like to thank all of those experts for their time and input. The full list of attendees is available in Annex A.

The authors would also like to thank Dirk Pilat, Deputy Director of the Directorate for Science, Technology and Innovation and Nick Johnstone, Head of the Structural Policy Division in the Directorate for Science, Technology and Innovation for their support of this work and input during the process and on drafts of the report.

In addition, the authors thank the Directorate for Employment, Labour and Social Affairs for their contributions to this work, particularly in Chapter 5 which uses data from the OECD Social Expenditure database and builds upon their work on social policy.

The authors also thank colleagues from other OECD Directorates for their input including the Centre for Entrepreneurship, specifically Antonella Noya and the Development Centre's Network of Foundations Working for Development. Other Directorates engaged in the work have included Development Co-operation Directorate, Statistics Directorate, Directorate for Financial and Enterprise Affairs, and Directorate for Public Governance and Territorial Development.

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ABBREVIATIONS

CBA	Cost-Benefit Analysis
CEA	Cost-Effectiveness Analysis
CIC	Community Interest Company
CSR	Corporate Social Responsibility
DFIs	Development Finance Institution
EVCA	European Venture Capital Association
EVPA	European Venture Philanthropy Network
GIIN	Global Impact Investing Network
LCC	Limited Liability Company
MRI	Mission-Related Investing
NAB	National Advisory Board
NPI	Non-Profit Institution
NSO	National Statistical Office
NVCA	National Venture Capital Association
PRIs	Program Related Investments
SE	Social Enterprise
SIFI	Social Investment Finance Intermediary
SII	Social Impact Investment
SIITF	Social Impact Investment Taskforce established under the UK’s presidency of the G8
SPO	Social Purpose Organization
SRI	Socially Responsible Investing
WGAA	Working Group on Asset Allocation
WGIM	Working Group on Impact Measurement
WGMA	Working Group on Mission Alignment

1. EXECUTIVE SUMMARY

Social impact investment is the provision of finance to organisations addressing social needs with the explicit expectation of a measurable social, as well as financial, return. Social impact investment has become increasingly relevant in today's economic setting as social challenges have mounted while public funds in many countries are under pressure. New 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 impact investment 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. Chapter 2 provides further background on the evolution of the market as well as highlights parallels to traditional capital markets.

Awareness of the potential opportunities of social impact investment has grown considerably across several OECD and non-OECD countries including in the G8 and G20. In the context of the UK's G8 presidency in 2013, the UK Prime Minister hosted a G8 Social Impact Investment Forum in London in June 2013 and launched the Social Impact Investment Taskforce. As one of the outcomes of the G8 Social Impact Investment Forum, the OECD was asked to produce a report on the social impact investment market. This report seeks to provide a framework for building the evidence base of the evolving social impact investment field. It follows an overview paper on social impact investment, published by the OECD in July 2014.[1]

A growing range of actors are emerging in the social impact investment market to form an ecosystem consisting of social ventures, intermediaries and investors committed to addressing social needs. Government also plays a key role in the ecosystem, in terms of setting conditions for the enabling (or hindering) environment as well as potential indirect or direct engagement in the market. Framework conditions (e.g. tax and regulation) have a significant impact on the social impact investment market. Chapter 3 provides a framework for looking at the various components of the social impact investment ecosystem and the different channels through which SII takes place.

The social impact investment market is in the early stages of development. The international initiative, led by the Social Impact Investment Taskforce, established under the UK's presidency of the G8, has helped in raising awareness and clarifying the broader definition of social impact investment. However, for purposes of scoping and sizing the market, it is essential to work towards a precise common understanding of what is meant by social impact investment and agree upon a working definition to clarify what is included and what is not. This is important for policy makers, researchers and practitioners as well as for the overall development of the market.

Chapter 4 of this report expands on the definition with the aim of spelling out the underlying criteria for assessing a social impact investment. It also provides a framework to help in working towards a common detailed definition, which in turn will facilitate data collection and a better understanding of the market. Seven key characteristics of social impact investment are identified in the paper including the

1. Wilson, K. E. (2014), "New Investment Approaches for Addressing Social and Economic Challenges", *OECD Science, Technology and Industry Policy Papers*, No. 15, OECD Publishing. DOI: 10.1787/5jz2bz8g00jj-en

social target areas, the beneficiary context, the nature of good\service provided (public/private), delivery organisation social intent, measurability of social impact, investor social intent and return expectations. Within each characteristic, a further set of related attributes are highlighted and possible boundaries are suggested to help further the discussion about what should and should not be considered social impact investment.

The market is evolving in various ways across OECD countries. This is influenced by the differences in the country context including history, social 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. The variation in these contexts can provide indications in terms of which SII approaches may be more appropriate in some sectors than in others, and easier to implement in some countries than in others.

Social needs have been increasing in many countries requiring both more efficient and more effective social service delivery. Trends in public expenditure show that services are taking up more of the social protection budget, in some cases exceeding cash spending. However, social service delivery is complex and entails a number of specificities and potential challenges for social delivery organisations as well as for social impact investment models. The extent to which any investment can make a social impact will rely on the type and extent of need – and demand for improvement – across an array of social outcomes. Social outcomes are evolving in different directions, in different social sectors, for different reasons. These topics are discussed in detail in Chapter 5.

A stronger evidence base is critical to increasing engagement in the social impact investment market and encouraging a global market to develop. Different players involved in the market, including policymakers, have been calling for more data as well as a better and more accurate understanding of the size, scope, evolution and potential of the market. However, the specific data requirements for each of these players can differ. It is therefore important to clarify these needs before embarking on a data collection exercise, especially given the challenges in collecting social impact investment data.

Currently, available data on social impact investment is very limited. Various approaches have been used to collect data and estimate the scope of the social impact investment market, but each of these approaches requires strong assumptions or has other limitations. Being able to collect comprehensive transaction data in an efficient manner would help in building a better understanding of market activity. This would require specific common definitions of social impact investment as well as harmonisation of data collection efforts to ensure comparability across countries and regions. Various efforts are underway but the best way forward will likely involve a partnership between key players involved in data collection across countries. These approaches are outlined in Chapter 6.

The public sector can play a catalytic role in the social impact investment market in terms of creating a conducive regulatory environment, encouraging greater transparency and taking concrete steps to help develop the market. Policy actions in some of these countries have addressed regulatory issues, notably in terms of setting up legal structures to accommodate SII-specific types of market actors. Also, several policy interventions have sought to enhance SII supply. Some governments have provided support through tax credits (and tax-advantaged funds), guarantees or subsidies, established and co-invested in SII funds. Other governments have focused on developing the social impact investment market infrastructure through the creation of intermediaries such as SII wholesale banks, exchanges (or trading platforms) and other channels to facilitate the links between supply and demand for SII (investors and delivery organisations). Additionally some have sought to stimulate SII demand by providing support to delivery organisations/investees through technical assistance or by encouraging procurement.

Depending on the type of actions taken, they might be implemented 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. In particular, differences in the context of developed and developing countries should be considered when applying social impact investment models. SII can also catalyse additional capital flows into developing economies, critical to the current high-level dialogue on Financing for Development and the development of the new Sustainable Development Goals.

When or if policies with the objective of supporting SII, such as tax incentives, are put in place, it is important that the policy interventions are well targeted, transparent and well-coordinated with existing policies as well as with the market. Policies should also be consistent 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 they are having the intended results. Chapter 7 highlights some of the social impact investment policies currently in place in the G7 countries and Australia and discusses broader policy implications in building the market.

Social impact investment can potentially provide new ways to more efficiently and effectively allocate public and private capital to address social and economic challenges at the global, national and local levels. While these innovative new approaches will not replace the core role of the public sector or the need for philanthropy, they can provide models for leveraging existing capital using market-based approaches with potential to have greater impact. However, given that social impact investment is a nascent field, concrete evidence is needed in terms of its impact to date. In particular, further work is needed to demonstrate the gains from the social impact investment approach compared to existing social service delivery models.

This report provides a framework for assessing the social impact investment market and focuses on the need to build the evidence base. The report highlights the importance of further international collaborations in developing global standards on definitions, data collection, impact measurement and evaluation of policies as well as experience sharing between players in the market. International organisations, such as the OECD can play an important role in facilitating these collaborations as well as conducting further analysis and data collection.

2. OVERVIEW OF SOCIAL IMPACT INVESTMENT

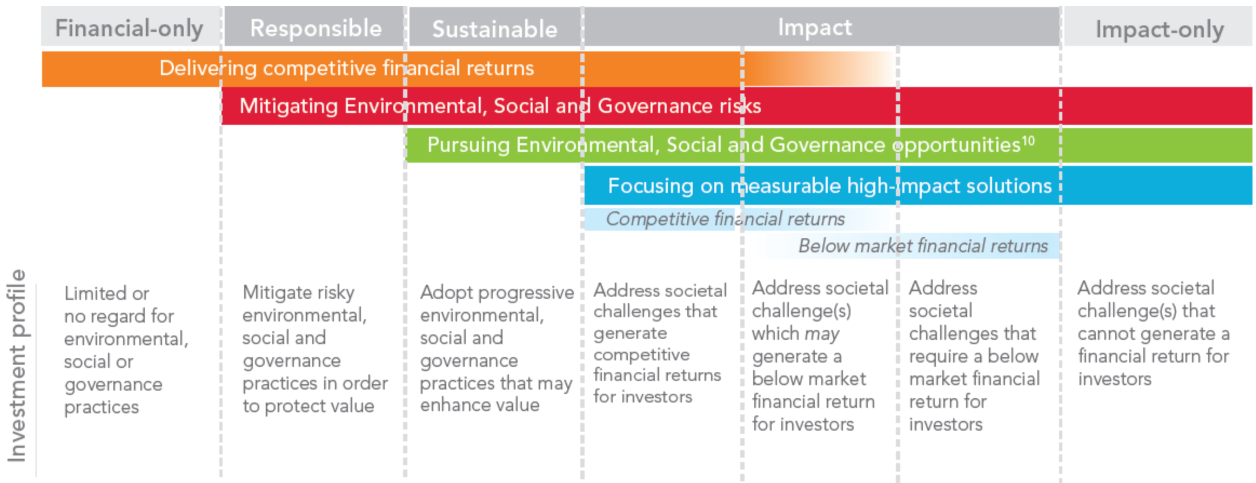
This chapter provides an overview of social impact investment highlighting its policy relevance in today's economic and social environment. It starts by discussing the growing need for new approaches for solving economic and social challenges and the role that social impact investment can play in that respect. It then provides an overview of current trends, opportunities and challenges in the social impact investment market. It also shows how the market is evolving and compares that to parallels in the evolution of the capital markets.

2.1. The need for new approaches to address social and economic challenges

2.1 Social impact investment (SII) is the provision of finance to organisations with the explicit expectation of a measurable social, as well as financial, return. Social impact investment has become increasingly relevant in today's economic setting as social challenges have mounted while public funds in many countries are under pressure. New 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.

2.2 SII involves private investment that contributes to the public benefit. Investors can range from those who are willing to provide funding for organizations that are not able to generate market returns to more traditional investors but with an interest in also having a social impact.

Figure 2.1. A Spectrum of Capital



Source: SIITF WGAA (2014).

2.3 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.

2.4 Social impact investment 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 recognising that private sector models can provide new innovative approaches.

2.5 The growth of social enterprises over the past several decades (Noya, 2009; OECD/EU 2013) has also contributed to the emergence of social impact investment. Social enterprises seek to develop innovative ways to tackle social challenges. These organisations need capital to grow but often face greater obstacles than mainstream firms (Noya, 2009). In response, a social impact 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.

2.6 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). The traditional view has been that pursuing social or environmental objectives could require some financial trade-off, although not necessarily a financial loss. As experience in the market has developed, a growing number of examples demonstrated that, in certain areas, social impact investments can generate both a financial and social return. It is in these areas that social impact investors can play a role in providing private capital to address social challenges in innovative news ways.

2.7 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.

2.1.1. Motivation for the OECD report

2.8 Social impact 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). Interest in social impact investment has grown considerably across several OECD countries including the G8 and G20.

2.9 In the context of the UK's G8 presidency in 2013, the UK Prime Minister 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 and provided an opportunity to launch processes and initiatives to facilitate the development of the market on a global scale. A Social Impact Investment Taskforce (SIITF) was established, consisting of one public and one private sector representative from each of the G7 countries and the EU.[2] The taskforce includes an observer from Australia and one from OPIC as a representative of Development Finance Institutions.

2. In mid-2013, Russia had chosen not to participate as the topic was not a priority for Russia.

2.10 As one of the outcomes of the G8 Social Impact Investment Forum[3], the OECD was asked to produce a report on the Social Impact Investment market. The work on the OECD report took place in parallel with the work of the Social Impact Investment Taskforce and its four Working Groups. National Advisory Boards, created in late 2013 in the G7 countries and Australia, met on a regular basis to provide input to the work of the Taskforce as well as to identify ways to develop the social impact investment market in each country. Reports from the Taskforce, its Working Groups and its National Advisory Boards were published in September 2014.[4] These reports were developed to feed into future international policy discussions, with G8 and G20 countries and beyond.

2.11 This report is the result of the first phase of the OECD work in the context of this international initiative. The paper seeks to provide a framework for building the evidence base of the evolving social impact investment market. This report, which was supported by several G8 member countries, builds upon existing work at the OECD including the research on social impact investment and new investment approaches conducted with support from the Bertelsmann Foundation during 2013 (Wilson, 2014) as well as other work across the OECD.

2.12 Social impact investment has become a growing area of interest within the OECD, linking to two strategic OECD initiatives, New Approaches to Economic Challenges (NAEC) and Inclusive Growth as well as ongoing work across a number of Directorates. This includes ongoing work within the Directorate for Science, Technology and Innovation on entrepreneurship financing and innovation, including inclusive innovation. It also builds upon work conducted in the Directorate for Employment, Labour and Social Affairs related to social policy. In addition, the project links to work conducted over the past decade in the Centre for Entrepreneurship's LEED programme on social enterprise, the Development Centre's Network of Foundations Working for Development and their recent work on venture philanthropy and the Development Cooperation Directorate's initiative on public/private financing for development. There are also further connections to ongoing work by the OECD Secretariat in the Statistics Directorate, Directorate for Financial and Enterprise Affairs, the Directorate for Public Governance and Territorial Development, and other OECD Directorates.

2.13 The field of social impact investment is expanding rapidly with a growing number of players entering the market; however there is not yet enough knowledge and evidence about the market, activity and outcomes. This initiative is therefore timely and will help inform OECD member countries as well as non-OECD countries about developments in this area and the potential role of policy.

2.2. Evolution and trends in the social impact investment market

2.14 Social impact 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.

2.15 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 and growing group of "responsible" investors seeking socially responsible and sustainable investments (Addis et al, 2013). Today, a growing number of companies have begun focusing on environmental and social issues or practicing corporate social responsibility (CSR). However, as noted by the SIITF, these investments have "tended to focus on the intentions and approaches

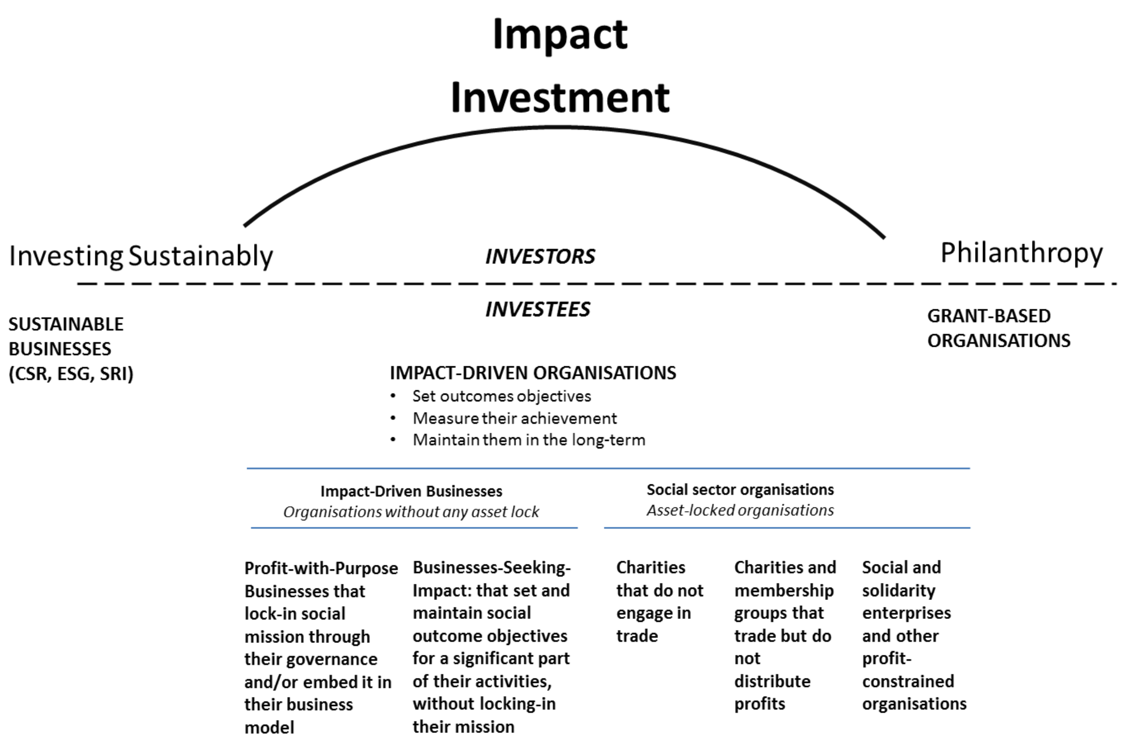
3. Further information available at: https://www.gov.uk/government/groups/social-impact-investment-taskforce.

4. The Taskforce, NAB and Working Group reports are available at: http://www.socialimpactinvestment.org/

of companies rather than on the measured achievement of impact goals" as required by social impact investors (see Chapter 4 for further details on definitions of SII).

2.16 Figure 2.2 below, developed by the Social Impact Investment Taskforce, shows the impact continuum in which social impact investment lies in between "sustainability" (specifically referring to CSR, ESG and SRI) and philanthropy but does not include either – only investments (e.g. not grants) that proactively seek a measurable social impact alongside a financial return. However, many providers of grants, such as foundations, are also social impact investors. Also, some businesses that have traditionally practiced CSR, ESG or SRI have also moved into the social impact investment space. The role of foundations and other investors is discussed further in Chapter 3.

Figure 2.2. The SIITF Impact Continuum



Source: SIITF (2014).

2.17 Social impact 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 (GIIN, 2014). Chapter 4 discusses the areas that fall within the OECD SII definition.

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

2.19 Initiatives being led by governments, foundations, investors and others have helped accelerate the market in the past few years (Jackson and Associates, 2012). A number of OECD countries, such as the UK, US, France and Australia, have played a leading role in developing the social impact 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.

2.20 Given that countries are at different stages of development, the 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 raising awareness about social impact investment and how countries might engage. These activities have also helped spur additional action within those and other countries and attract new players to the market.

2.21 While Phase I of the international initiative focused on the social impact investment markets and policies in G7 countries and Australia, there was a Taskforce Working Group looking into the implications for international development[5].The next phase of the initiative is planned to expand its engagement and focus to the G20 countries and beyond. There is a growing recognition that traditional sources of development financing, in particular official development assistance (ODA), are not sufficient to address the scale and complexity of today's global development challenges. Partnerships are needed that encourage better collaboration between the public and private sectors and ways need to be found to use ODA in a smart way to facilitate these partnerships as well as mobilise additional resources.

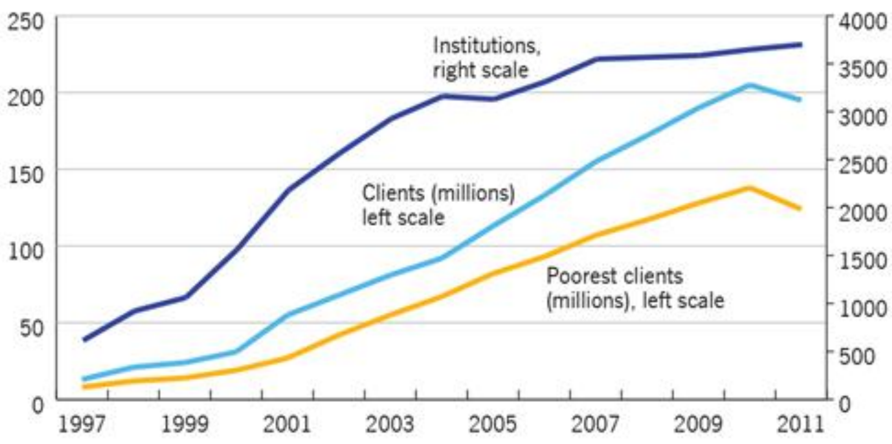
2.22 International aid agencies are searching for new tools, including results-based financing, outcomes-based approaches, market-based solutions and different forms of public-private partnerships, to increase their effectiveness and long-term development impact while working with the limitations of tighter budgets. Social Impact investing has the potential to catalyse new capital flows into developing economies, translating experiences, policies and approaches from developed countries into the emerging and less developed country context.

2.23 While the social impact 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 (Saltuk et al, 2014). 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 impact investment market potential has been estimated to be significant. This is due to growing interest among foundations and mainstream investors as well as an intergenerational transfer of wealth, estimated at USD 41 trillion that 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).

2.24 The microfinance industry was an early model of changing approaches to financing which also addressed social needs. The microfinance market is estimated to include 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 estimated similar possible annual growth rates for the social impact investing market (Freireich and Fulton, 2009; O'Donohoe et al., 2010).

5. See the Working Group report for further details: Social Impact Investment Taskforce (2014), Subject Paper of the International Development Working Group: International Development

Figure 2.3. Microfinance: clients and institutions globally, 1997-2011



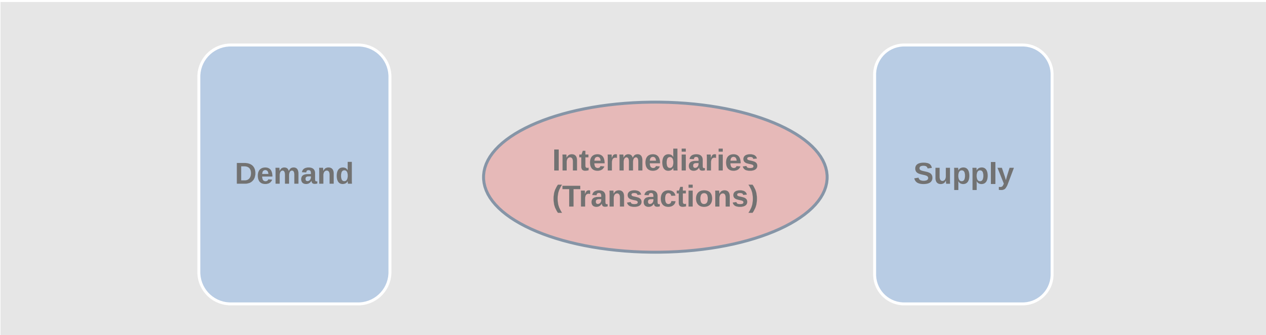
Source: OECD based on Maes and Reed (2012).

2.25 It should be noted, however, that the microfinance industry had a lot of government support, in the form of grants and low-interest loans, before it got to the more stable and self-sustaining commercial state that it has now reached.

2.3. Parallels to the evolution of capital markets

2.26 Social impact investment financing models are emerging at multiple levels and in parallel to traditional markets. As in capital markets, financial intermediation plays a critical role as there are information asymmetries between investors and investees. Intermediaries play a critical role in connecting demand and supply, particularly in financial markets that are less developed.

Figure 2.4. Financial Intermediation



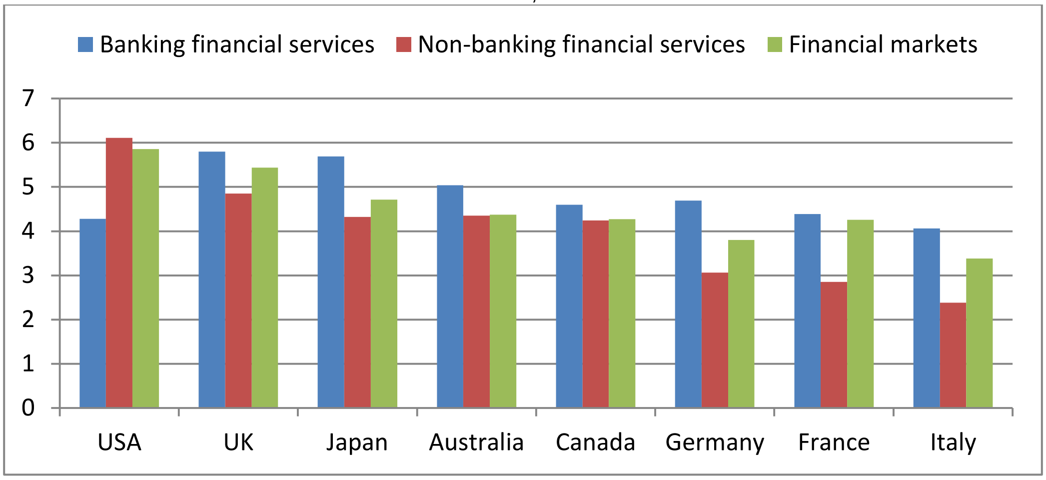
Source: OECD.

2.27 In the traditional capital markets, intermediation is focused on financial dimensions. The social impact investment market is more complex as social dimensions also need to be valued. Transaction costs in social impact investment are high due to fragmented demand and supply and the complexity of deal structuring. For these reasons, coordinating capital for social ventures is more difficult than in the venture capital industry (Kohler et al, 2011). Given the high costs and early stage of market development, there is a lack of brokers, advisors, exchanges and other market mechanisms, resulting in a market with imperfect market competition.

2.28 The degree of financial sector development within a country can potentially have an influence on the development of the social impact investment. Figure 2.5 below shows the difference in financial sector development in the G7 countries and Australia according to a 2012 World Economic Forum report. It can be noted that the most active social impact investment markets are currently in the two countries with the most developed financial sectors.

Figure 2.5. Financial Sector Development

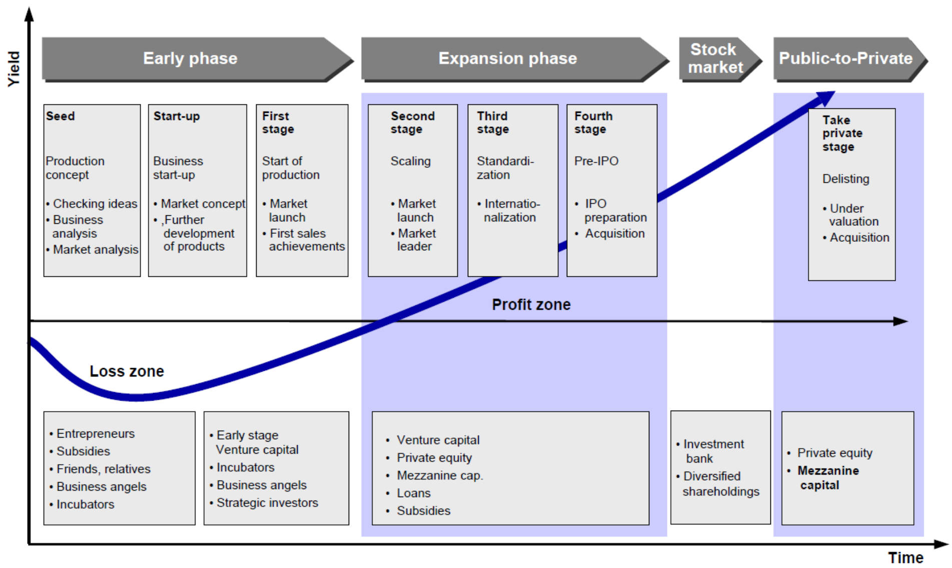
Scores 1 to 7, as of 2012



Source: OECD based on WEF (2012).

2.29 The development of capital markets often leads to availability of a range of products across the risk return spectrum. Different types of financing instruments may be more appropriate for different stages of the development of a venture (Wilson and Silva, 2013). Figure 2.6 illustrates a typical life-cycle of a firm along with the various stages of financing and types of financing instruments. The figure below highlights the complexity of financing and the need for a mix of instruments to address the various growth phases of a firm.

Figure 2.6. Life-cycle of a firm and stages of financing



Source: OECD (2013a) based on Natusch (2003).

2.30 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).

2.31 While the players, financing needs and mix of instruments differ from traditional finance, social impact investment instruments span asset classes and can include equity, quasi-equity, loans and bonds. A growing range of social impact investment instruments have been developed, all with a different financial/social return profile. However, given the early stage of market development, there is a lack of products across the risk/return spectrum making it more difficult to attract investors, particularly more mainstream ones.

2.32 The existence of vibrant entrepreneurial finance markets can facilitate the development of the social impact investment market as experience with financial market tools can help in building the SII market. In fact, many people in SII were active in investment banking, private equity, venture capital and/or angel investing.

2.33 Comparisons are sometimes made between the evolution of the social impact investment market and 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 U.S. government interventions, including a legislation in the 1950s that allowed privately funded investment firms to provide capital to early-stage funds, 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 1970’s, 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 impact investment movement, in the U.K. and globally, and the Chairman of the Social Impact Investment Taskforce established by the G8 in 2013.

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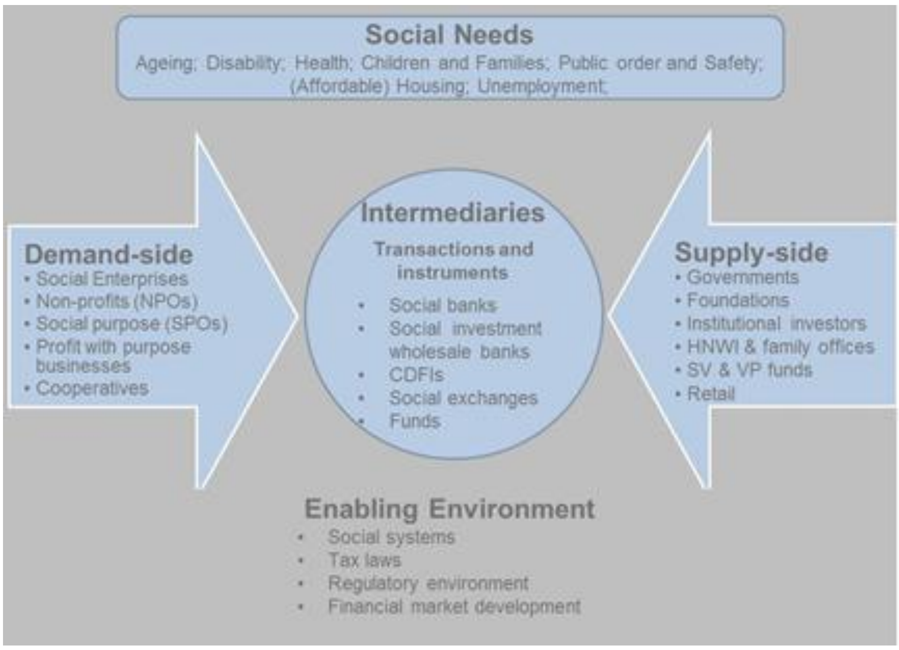
3. THE SOCIAL IMPACT INVESTMENT FRAMEWORK

This chapter provides a framework for looking at the social impact investment market, starting with social needs and then looking at the demand and supply sides of the market as well as the role of intermediaries. Examples of key types of players in the market are given to provide further context. The role of the enabling environment is also discussed as a key part of the framework.

3.1. The Social Impact Investment Framework

3.1 A growing range of actors are emerging in the social impact investment market to form an ecosystem consisting of investors, social ventures and intermediaries and a comprehensive picture of the SII market requires assessing the different components of the market (Figure 3.1). The main components of the ecosystem are driven by SII demand (including social needs and social service providers), SII supply (i.e. pools of capital and investors) and the role of SII intermediation and intermediaries (including transactions and financing instruments). The enabling environment, including framework conditions (e.g. social systems, tax and regulation), also can play a critical role in the social impact investment market and must be taken into consideration when looking at the SII ecosystem.

Figure 3.1. Social Impact Investment Market Framework



Source: OECD.

3.2 Progress in the social impact investment market will depend on different stakeholders working together to build critical mass by developing the market, tools and practice. Those stakeholders include investors, investees and intermediaries as well as policy makers, all with varying interests and motivations. Building trust is important, and market transparency is essential to building this trust (IIPC, 2014).

3.2. Social needs

3.3 Social impact investment starts with the social need being addressed. These can cover a wide range of social need areas such as ageing, disability, health, children and families, affordable housing, unemployment, etc. The types of beneficiaries of social impact investment can also vary. These issues are described in further detail in Chapter 4. In addition, the social context and social systems within a country can vary dramatically and have a huge impact on the potential opportunities for SII. This is discussed in detail in Chapter 5.

3.3. Demand-side

3.4 The key drivers in addressing social needs are the service delivery organisations. These organisations can include community organisations, charities or non-profit organisations, social enterprises, social businesses, and social impact-driven businesses. In some countries, only non-profit organisations are considered "social", however rules are changing to include for-profits with a targeted social purpose.

3.5 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 (OECD, 2000) as an innovative business model for meeting social and economic objectives, that embodies constraints on the distribution of profits and/or assets, however, the organisational structures and legal forms vary widely across countries (Noya, 2009).

3.6 Social delivery organisations operate in a wide range of geographies and sectors and therefore have varying financing needs. The development of financial instruments across the full risk/return spectrum is needed to meet the varying needs of these enterprises. However, this requires a better understanding of which financial instrument and funding model would be most effective for social ventures at various stages of development (Evenett and Richter, 2013). In addition, some of these organizations are becoming hybrids (Glänzel et al., 2013) and therefore are pursuing a mix of funding approaches. The OECD CFE\LEED has worked extensively on social enterprises, particularly at the local level (e.g. OECD, 2013b).

Box 3.1. Financing challenges for social enterprises

Access to capital is vital to the creation and development of social enterprises. Social enterprises are usually financed by a combination of market resources (e.g. the sale of goods and services), non-market resources (e.g. government subsidies and private donations or investments), and non-monetary resources (e.g. volunteer work).

Grant financing, whether from governments, foundations or others, may be required at an early stage of development and can be reduced as social enterprises build scale and market capacity. However, in some cases, secure long-term funds may be needed, for example, in certain sectors in which social enterprises are not able to become self-financing but whose activities provide public benefits and/or reduce public costs.

For social enterprises that are to obtain additional financing, a diversity of private market financial products that correspond with the life-cycle of social enterprises (from start up or even pre-start up, to consolidation and growth) is needed. One of the key financial products used by most mainstream enterprises is bank loans. However, in most OECD countries, social enterprises have difficulty obtaining access to credit. Traditional financial institutions generally refuse to lend to social enterprises because they do not meet their established client criteria and are not seen as offering sufficient guarantees. Consequently, they must seek new financial partners or reduce their development ambitions.

OECD countries are seeing the emergence of a number of new financial instruments and actors to support social enterprises, together with broader investment criteria for existing financial actors and behavioural shifts among actors already engaged in supporting civil society initiatives (Noya, 2009). Interest and activity in social impact investing, which focuses on proactive investment choices aimed at supporting social enterprises that can have a strong social impact while seeking some financial return, is growing and can contribute to the scaling and growth of social enterprises.

Source: OECD/EU (2013).

3.7 A recent survey showed that business model execution and management is seen by investors as the highest risk to their investments in social ventures (Saltuk et al, 2014). As with traditional businesses, some new ventures will fail to achieve their goals. The reasons for failure of these ventures can vary from management, strategy or funding to regulatory and administrative barriers. However, reports have shown 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.

3.8 Social impact investors, as well as targeted policies, can play a role in improving the effectiveness of social ventures (Jackson and Associates, 2012). Social impact investors can help social delivery organisations 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 impact investment is reliant on the long term sustainability and performance, both social and financial, of the impact organizations, for-profit and not-for-profit, in which the investments are made (Bannik and Goldman, 2012).

3.9 Investment readiness remains a key issue for social ventures in many countries. Enhancing the investment readiness and business capability of these organisations is important to enable them to access SII (HM Government, 2011). Creating more investable social ventures 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).

3.10 The UK launched a GBP 10 million strategic fund, the Investment Contract and Readiness Fund, to help social enterprises secure capital. The Fund helps with investment readiness and enables social ventures to access new forms of investment and compete for public service contracts. Grants between GBP 50 000 and GBP 150 000 are available to social ventures which go on to raise at least GBP 500 000 investment, or which want to bid for contracts over GBP 1 million. The Boston Consulting Group (BCG) conducted an independent interim review by in April 2014 and determined that the fund was having a "significant and positive impact" (BCG, 2014).

3.11 Social ventures can also face challenges in a number of other areas including finding adequate legal forms or conforming to impact assessment standards. Transaction and reporting requirements can be high for social enterprises (OECD, 2013b). As the focus on impact measurement has increased, so have the pressures on social enterprises to comply 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.

3.12 Mission drift is another challenge for social impact 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. A Working Group of the SIITF was dedicated to this important topic and it is also covered further in Chapter 4.

3.4. Supply-side

3.13 On the supply side, capital providers are increasingly interested in social impact investment as a way to diversify their investments and pursue social, as well as financial, goals. These include foundations, high net worth individuals and philanthropists, banks and other financial services firms and intermediaries. To date, the most active social impact investors have been high net worth individuals (HNWI) and family offices, who have more flexibility and autonomy than other investors (WEF, 2013). Interested high net worth individuals may invest individually or possibly through the small but increasing number of angel investment groups focused on social impact investment (OECD, 2011).

3.14 Foundations have played a critical role in the development of the social impact investment market (Koh et al., 2012). This role can range from building market infrastructure, such as Rockefeller Foundation has done in the U.S. and the Bertelsmann Foundation in Germany, to providing "catalytic" capital or actively investing, through programme related investments (PRI) programmes. Private foundations have the advantage of being independent from government and the markets and therefore are in a position to take on greater risk than other private investors and provide long-term 'patient' capital. This gives them the freedom to explore and create innovative ways to address social, economic and environmental challenges.

3.15 Grants, both public and private, continue to play an important role by providing "first loss" or "catalytic" funding (GIIN, 2013). Grants and technical assistance are often needed before or alongside SII to help social ventures addressing social challenges develop commercially-viable solutions (Bridges Ventures, 2012). In addition to foundations, Development Finance Institutions (DFIs) have also played an important role as "catalytic" funders in the market.

3.16 While grants are not considered social impact 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). However, in those cases, it is important for the foundations to distinguish between grants, which in reality provide a 100% "subsidy" versus investments which involve risk and therefore an expectation of returns. In essence, there are various forms of support and financing for social ventures and different types of investors will look at the spectrum of investment options with their own risk/return requirements in mind. Return expectations are discussed in further detail in Chapter 4.

Box 3.2. PRI: Bill & Melinda Gates Foundation (US)

The Gates Foundation focuses on tackling poor health and extreme poverty globally, as well as education challenges in the US. The Gates Foundation has been a very active and leading player in SII, in particular through a PRI approach that was adopted in 2009. Since then, funds through PRIs, to organisations tackling social issues have risen considerably reaching an allocation of more than $1.5 billion as of 2012. PRIs allow the foundation to work in close collaboration with the private sector to align the foundation's programmatic (social) goals with the financial objectives of other investors.

The Table below provides examples of investments that while having the potential to generate financial returns, are made within the scope of the programmatic and charitable objectives of the Gates Foundation. In particular, the Africa Health Fund tackles poor health and ASA International contributes to ending extreme poverty in Africa and Asia. The investments into Aspire Public Schools, a charter school management organisation in the US, address educational challenges of low-income communities and students.

Examples of Gates Foundation PRI activity

PRI Name	Social focus	Financing Instrument	Goal
Africa Health Fund	Tackling poor Health	Private Equity Fund (co-investment)	Improve access to finance for African healthcare companies
ASA International	Financial Services for the poor (microfinance)	Low Interest Loan	Affordable financial services to low-income individuals and small businesses in underserved markets in Africa and Asia
Aspire Public Schools	Education	Partial backstop guaranty (with co-guarantors)	Aspire opens and operates charter schools in low-income neighborhoods

Source : Gates Foundation website: www.gatesfoundation.org/How-We-Work/Quick-Links/Program-Related-Investments/

3.17 The PRI approach goes beyond grant-making models traditionally used by foundations insofar as it builds on a set of financial instruments ranging from direct debt, equity, guaranties and (debt or equity) funds. At the same time, PRIs are linked to the foundation's grant programme themes. These financing instruments are used to further the programmatic and charitable objectives of foundations. The use of innovative funding mechanisms allows foundations to attract other (co-) investors and involve them in the social mission. In doing so, PRI is a model aiming to tackle social challenges and yield social outcomes as its primary objective. In some cases PRIs have the potential to generate financial returns (usually below market), but this is never the main purpose of the investment. These investments count towards the foundation's charitable distribution requirement, but can be considered as assets (or liabilities) that leverage the foundation's endowment.

3.18 According to the recent J.P. Morgan and Global Impact Investing Network (GIIN) survey, program-related investments (PRI) allow foundations to use "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). A growing number of foundations are engaging in PRI. Box 3.2 below provides some examples from the Bill & Melinda Gates Foundation's approach to programme related investing.

3.19 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. A recent World Economic Forum report provides practical steps to be taken in order for mainstream investors to engage in social impact investment (WEF, 2014).

3.20 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 impact 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). These issues are discussed further in the recent SIITF Working Group paper "Allocating for Impact".

3.21 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. More products are being developed, across the risk return spectrum, into which institutional investors can deploy social impact investment funds.

3.22 Some social impact investors are finding it helpful to focus on investment within specific sectors (Bannick and Goldman, 2012). This enables a concentration on providing expertise and building the necessary links within a specific sector and thinking about social businesses in the context of the sector ecosystem.

3.23 Individual citizens are also able to participate, whether through investments in the local community or through pension funds with a social return element, such as the "Solidarity Funds" in France. Solidarity funds, or "90/10" funds as they are often called, are based on employee pension plans and savings. Companies with over 50 employees can contribute and 10% of those 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 (or that returns on the other 90% will be higher).

3.24 According to a recent Triodos report, "retail" or citizen participation in social impact investing is a promising development which can be vital to the long term success of the market. The report suggests the creation of social impact investment funds for retail investors, the expansion of impact-enabled employee savings and pension plans with funds dedicated to social impact investment and tax incentives for retail impact investments (Triodos, 2014).

3.25 Crowdfunding platforms are also increasingly providing access for retail investors to support social enterprises. While most crowdfunding for social causes is donation-based (Wilson and Testoni, 2014), increasingly, equity crowdfunding platforms are providing investment opportunities in some countries, although equity crowdfunding is still not allowed in many countries due to investor protection rules.

3.26 Finally, the public sector clearly plays a central role through the commissioning of social services by national government departments, local authorities and other government agencies as well as through direct or indirect support of the SII market. These topics are discussed in further detail in Chapter 5.

3.5. Intermediaries

3.27 Intermediaries can play a pivotal role in developing the social impact investment ecosystem. They provide the links between investors, investees and others in the 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). They also provide advice as well as help in structuring deals and in managing funds.

3.28 The lack of efficient intermediation in the social impact investment market translates into higher transaction costs caused by fragmented demand and supply as well as complex deal structuring (Freireich and Fulton, 2009). The early stage of ecosystem infrastructure development impedes the dialogue between investors and social ventures, which makes it difficult to break down historical barriers 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.

3.29 Intermediaries can include commercial banks, investment banks, independent financial advisors, brokers, dealers, and exchanges. The creation of new specialist intermediaries and the strengthening of existing ones are important for creating a well-functioning ecosystem as well as enabling deal flow (Jackson and Associates, 2012). Various types of intermediaries are needed to serve all sizes of impact-driven organisations (Addis et al, 2013) and players in the ecosystem need to be encouraged and incentivised to collaborate.

3.5.1. Social Venture Funds

3.30 Social venture funds started over a decade ago and are becoming more prevalent. However, most of the funds are young and small, often without a track record, making it difficult to attract institutional investors (GHK, 2013). These typically follow 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).

3.31 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).

3.32 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.

3.33 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. Bridge Ventures, a private investment firm, created in the U.K. in 2002, is dedicated to using an impact-driven investment approach to create superior returns for both investors and society at-large. Bridges Ventures began by investing in for-profit ventures in underserved communities and later created a Social Entrepreneurs Fund.

3.34 Social venture investors face 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 in 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.

3.5.2. Social Stock Exchanges

3.35 Over the past several years, social stock exchanges have been created 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 (the latter two have since merged). 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.

3.36 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 a 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 has a number of listed member companies.

3.37 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.

3.38 In 2013, Nexii and IIX Asia agreed to collaborate to strengthen and standardise the impact investing sector and later merged. 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. 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.

3.39 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 organisations 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.

3.5.3. Building Market Infrastructure and Capacity

3.40 Creating the necessary infrastructure and building capacity is important to the development of the market and, as a result, a number of these initiatives have been led by governments, foundations and others (IIPC, 2014). 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 important 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.

Box 3.3. Big Society Capital (BSC)

Big Society Capital (BSC) is an independent financial institution in the U.K. established to develop and shape a sustainable social impact 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 impact investment bank in the world.

BSC is a 'social impact investment wholesaler' which provides finance to social impact 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 impact 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: www.bigsocietycapital.com.

3.41 In the U.K., Big Society Capital (BSC) acts as a wholesale investor for social impact investment by investing in intermediaries and championing the sector to the public, stakeholders and investors (Box 3.3). BSC has also commissioned a number of research reports on the social impact investment market and created guides and standards for investors and social enterprises (Addis et al, 2013).

3.42 However, in most countries, intermediaries either do not exist or are not sufficiently developed to effectively facilitate the matching of SII demand and supply. Intermediaries and advisors are hard to finance due to high operating costs. Currently, most survive through donations. Others take transaction fees or a share 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.

3.43 Intermediaries, such as the Global Impact Investing Network (GIIN), described in Box 3.4, can also play an important role in encouraging "traditional" financial players to enter the market.

Box 3.4. 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: www.thegiin.org.

3.44 For investors to enter the SII market, the measurement of social impact is critical. Rating and certification agencies therefore 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.

3.5.4. Social Investment Instruments

3.45 As referenced in Chapter 2, the social investment market is developing in parallel to the current investment market in terms of products, funds and market structures. Typically, social impact investment entails the use of debt or equity instruments to deliver a social or environment “return” as well as a financial return. The balance between the two will differ 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).

3.46 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.

3.47 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.

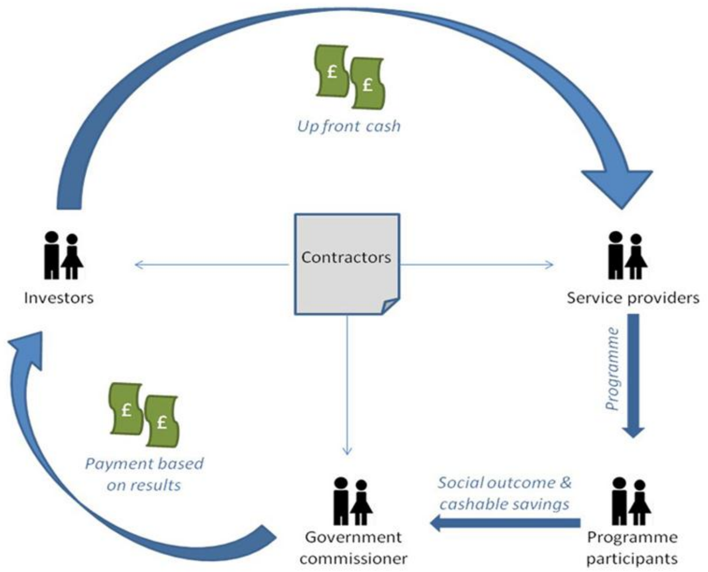
3.48 Today, most social investment is still in the form of grants, primarily from the philanthropic community, or secured loans. Venture philanthropists, who can operate across the spectrum of investment return, typically offer non-returnable grants for a purely social return while others use loan, mezzanine 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 with a goal of helping 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).

3.49 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.

3.50 "Pay for Success" instruments such as Social Impact Bonds (SIBs), first launched in the U.K. 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 public-private partnership models can contribute to much needed innovation in financing models as well as improvement in public service delivery. However, they can also be complex and time consuming to structure and implement (Addis et al, 2013).

3.51 A SIB is a type of public-private partnership that embeds a pay-for-success scheme, commissioned by public authorities, foundation or corporations to provide social (goods and) services. SIB commissioners have clear priorities in terms of social goals that need to be achieved in a more efficient way. So, they set up predefined and measurable target social outcomes. As depicted in Figure 3.2 below, social service providers, with a track record in addressing that particular social need, are provided funding in the form of investment by private investors. The investors in the SIB are then repaid based on the achieved outcomes, defined *a priori* by the SIB commissioner.

Figure 3.2. The SIB model



Source: UK Cabinet Office, available at: https://www.gov.uk/social-impact-bonds.

3.52 It is important to note that the focus on measuring outcomes (e.g. reduction of infection rates) is different from a focus on measuring outputs (e.g. number of vaccines provided). Transparency is ensured as outcomes are evaluated by an independent entity. The investors will be repaid, in tranches over time, only if the agreed upon outcomes are achieved. The payments and any positive returns on investment should reflect the innovation and more efficientsocial service provision provided by the social service delivery organisation.. For information on the evaluation of the first SIB created (in the U.K), see Chapter 7.

3.53 The SIB model spread quickly across the U.K. 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, child/family support, homelessness, employment, and health. These and many other new models are currently being developed in a growing number of countries. A list of SIBs is provided in Annex 3.1.

3.54 Building on the SIB model, Development Impact Bonds (DIB) are also structured as pay-for-success schemes but focused on developing countries. As with SIBs, investors are paid on the basis of whether the pre-defined social\development outcomes are achieved. DIBs seek to improve the effectiveness of traditional donor-funded projects by shifting the focus onto 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. However, it should be noted that applying these models in developing countries might entail additional challenges such as the extent to which DIB contract terms can be enforced. Annex 3.1 includes a number of DIBs currently being developed in countries such as India, Mozambique or Uganda. Contrary to SIBs, the typical DIB commissioner is not local governmental authorities but rather international organisations or development agencies — e.g. the UK's Department for International Development recently announced a DIB to invest in the prevention of deadly sleeping sickness in Uganda.

3.6. Enabling environment

3.55 The general framework conditions in a country can have a significant impact on the development of financial markets in general and the social impact investment market in particular. The existence of vibrant entrepreneurial finance markets can facilitate the development of the social impact investment market as experience with financial market tools can help in building the SII market (in fact, many people in SII were active in investment banking, private equity, venture capital and/or angel investing).

3.56 The SII 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 (Wilson, 2014). Chapter 5 provides further details on the social systems in the selected countries.

3.57 In addition, political economy considerations also play an important role, since SII may be perceived differently across and even within countries. Indicators that might proxy social perceptions can shed some light on these aspects. Information on social perspectives is usually obtained through surveys such as the World Values Survey or the European Social Survey Additional data may also be available from the OECD (e.g. Society at a Glance; Better Life Index, Annex 6.2), World Bank indicators or the Social Progress Index. Annex 6.1 provides a list of data sources with links to where this type of data can be found.

3.58 For the SII market to function well, the necessary legal frameworks and structures need to be in place for social ventures as well as streamlined regulations and requirements for investment (Thornley et al, 2011). This includes corporate structures more suitable to social ventures as existing structures (either for-profit or non-profit) may restrict the ability or flexibility of these organisations to attract investments in some countries. A number of new corporate structures are developing in various countries to meet the needs of hybrid social ventures. 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). Legal structures are discussed in further detail in Chapter 4 and also in Chapter 6.

3.59 Barriers to the development of the SII market include legal and civil frameworks for the creation and regulation of social organisations, as well as the availability of finance and market information for start-ups in this field. A number of countries have established legal precedents or civil codes for social ventures which aim to facilitate new social start-ups, reduce risks for both entrepreneurs and potential investors, as well as make up part of the system of regulation and review needed to assess social impact in countries.

3.60 Regulation, however, is a more complex contributor to the picture; on the one hand regulation may facilitate third party evaluation of social impacts (as with benefit corporations – see Reiser, 2013) and in turn help lower the risk for investors seeking social returns, and on the other may create additional costs for the enterprises themselves.

3.61 As discussed earlier, the availability of financial capital for social enterprises is a critical factor to facilitating or restricting private partners in social sectors. These can be from public or private sources with varying conditions attached. Also, the balance between private and public 'interest' might signal different expectations for financial/social returns from these enterprises.

3.62 Finally, the principle of a private social delivery organisation rests on having a social impact, which means the SII market in a given country is dependent on the availability of social outcome data, comparable public costs, and the present role of private finance in the delivery of social services. For a country to identify a possible 'market space' for SII, data is needed for assessing the business case for across multiple sectors or social target areas. Chapter 5 presents some of this 'market space' data for the G7 countries and Australia.

3.63 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 impact investment market by creating lighter regulation but may create additional barriers as decisions on how each fund will be treated will be determined at the national or local level. The legislation came into effect in the summer of 2013 and is described in further detail in Box 3.5.

3.64 Tax laws within countries have a huge impact on setting the conditions for social impact investment, primarily in terms of the rules surrounding non-profits, donations and investments. In some countries, governments have provided support to social impact investors and social sector organisations through tax credits, guarantees or subsidies. Additionally some have provided support to investees through technical assistance or procurement.

3.65 In the 2014 Budget, the U.K. Government announced a new Social Investment Tax Relief which will give individuals who invest in qualifying social sector 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 private investment in social sector organisations (HM Government, 2013c). In 2002, the Community Investment Tax Relief (CITR) scheme was devised to encourage private investment into CDFIs. The U.K. has several other tax incentive schemes for investments in small and medium-sized businesses (HM Government, 2013b), including the Enterprise Investment Scheme (EIS), the Seed Enterprise Investment Scheme (SEIS) and the Venture Capital Trust (VCT).

3.66 The U.S. also has some tax incentives in place. This includes the New Markets Tax Credits which provides a credit against U.S. 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.[6]

Box 3.5. European Social Entrepreneurship Funds

The European Social Entrepreneurship Funds regulation (EuSEF) provides a label for investment funds that address social issues. To qualify as an EuSEF, a fund has to prove that at least 70% of the capital received from investors is invested in social businesses and that no more than 30 % of its available capital is used in the acquisition of non-qualifying assets.

For investments to qualify, the investee must not be a listed company and must have a social goal, defined as "the achievement of measurable, positive social impacts as its primary objective" clearly stated in the documents establishing the business (statutes, mission, etc…). In addition, the investee must use its profits to achieve the social goal and ensure that any profit distribution does not undermine the social goal.

The investee is considered a social enterprise if it i) provides services or goods to vulnerable or marginalised, disadvantaged or excluded persons; ii) uses a method of production of goods or services that embodies a social objective; or iii) provides financial support exclusively to social businesses as described in i) and ii).

The EuSEF regulation foresees the following social areas for social entrepreneurship:

1. Employment and labour markets;
2. Standards and rights related to job quality;
3. Social inclusion and protection of particular groups;
4. Equal treatment, equal opportunities and non-discrimination;
5. Public health and safety;
6. Access to and effects on social protection and on health and educational systems.

Investments can be made through a number of financing instruments such as:

- Equity or quasi-equity instruments;
- Securitised and un-securitised debt instruments;
- Units or shares of other eusef (with exceptions);
- Secured or unsecured loans granted by the eusef.

A number of reporting obligations apply. In particular, EuSEFs must include in their annual report details of the social outcomes achieved with the investment policy as well as the social outcome measurement methodologies used. In addition, they must also report a number of investment-specific features, such as the:

- Social impact being targeted
- Criteria used to select the investments
- Risk profile
- Valuation and pricing methodology
- Methodologies used to assess social impact

Source: Regulation (EU) No 346/2013 of the European Parliament and of the Council on European social entrepreneurship funds.

6 . The Community Renewal Tax Relief Act can be found at: http://portal.hud.gov/hudportal/documents/huddoc?id=19129_actof2000.pdf

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ANNEX 3.1. LIST OF SIBS

Geography	Operational (as of 2014)	Social Need	Duration (years)	Outcome Payment	Investment Needed\Raised
New South Wales, Australia	No	Intensive Family Support Services	5	N/A	9.2
New South Wales, Australia	Yes	New Parent and Infant Family Support	7	7+	6.4
Brussels, Belgium	Yes	Employment	2	N/A	0.2
Nova Scotia, Canada	No	N/A	N/A	N/A	N/A
Saskatchewan, Canada		Children at risk of care	N/A	N/A	N/A
Medellin, Colombia	No	Teenage Pregnancy	4-5	N/A	N/A
Rajasthan, India	No	Education	N/A	N/A	N/A
Israel	No	Prevention of Type 2 Diabetes	N/A	N/A	N/A
Israel	No	Workforce development for Arab Israeli women	N/A	N/A	N/A
Israel	No	Dropout rates from engineering studies in tertiary education	N/A	N/A	N/A
Israel	No	Recidivism	N/A	N/A	N/A
Mozambique	No	Malaria	N/A	N/A	25-30
Punjab, Pakistan	No	Primary education	N/A	N/A	25
Swaziland	No	Prevention of HIV and TB	3	N/A	10
Uganda	No	Sleeping sickness	8	N/A	20-30
Uganda	No	Secondary education	10	N/A	35
Peterborough, UK	Yes	Recidivism	8	12.2	7.6
Essex County, UK	Yes	Foster care	5	10.6	4.7
Greater Merseyside, UK	Yes	Workforce development (Innovation Fund)	3	6.8	3
Shoreditch, London, UK	Yes	Workforce development (Innovation Fund)	3	4.9	1.4
Stratford, Canning Town, Royal Docks (Newham), Cathall (Waltham Forest), UK	Yes	Workforce development (Innovation Fund)	3	2.0	4.9
West Midlands (Birmingham), UK	Yes	Workforce development (Innovation Fund)	3	5.0	N/A
Nottingham City, UK	Yes	Workforce development (Innovation Fund)	3	4.4	N/A
Perthshire and Kinross, Scotland, UK	Yes	Workforce development (Innovation Fund)	3	1.8	N/A
West London, UK	Yes	Workforce development (Innovation Fund)	3	4.6	N/A
Cardiff and Newport, UK	Yes	Workforce development (Innovation Fund)	3	3.0	N/A
Greater Manchester, UK	Yes	Workforce development (Innovation Fund)	3	5.0	N/A
Thames Valley, UK	Yes	Workforce development (Innovation Fund)	3	5.6	N/A
London, UK	Yes	Homelessness	4	7.6	8
Manchester	Yes	Childcare	N/A	N/A	N/A
Wales, UK	No	Foster care	N/A	N/A	N/A
Cornwall, UK	No	Aging in place	N/A	N/A	N/A
Country-wide, UK	Yes	Adoption	10	N/A	3
Illinois, US	No	N/A	N/A	N/A	N/A

Massachusetts, US	Yes	Recidivism	7	27	18
New York City, US	Yes	Recidivism	4	2.1	9.6
New York State, US	Yes	Employment for formerly incarcerated individuals	5.5	21.5	13.5
National, US	No	Workforce development	N/A	20	N/A
Massachusetts, US	No	Homelessness	3	25	N/A
Salt Lake City, US	Yes	Early Childhood Development	1	N/A	7
California, US	No	Asthma Management	N/A	N/A	N/A
South Carolina, US	No	Neonatal care (Nurse Family Partnership)	N/A	N/A	N/A
Cape Town, South Africa	No	Criminal justice	N/A	N/A	N/A

Note: This table lists all the existing or announced SIBs by geography and social need as of 18, July, 2014. Figures on outcome payments and investment needed are expressed in millions of USD.

Source: Instiglio, available at http://www.instiglio.org/en/sibs-worldwide/, accessed on 30 August, 2014.

4. DEFINITIONS AND CHARACTERISTICS OF SOCIAL IMPACT INVESTMENT

This chapter discusses the challenges related to definitions in the social impact investment market and provides a working definition based on a set of criteria for determining what might or might not be included as social impact investment. This includes a discussion of the core characteristics and definitional attributes.

4.1. Existing definitions and challenges

4.1 While in the early stages of a market's development, it can be difficult to have precise definitions, for purposes of scoping and sizing the market, it is essential to work towards a common understanding of what is meant by social impact investment and agree upon a working definition to clarify what is included and what is not. This is important for policy makers, researchers and practitioners as well as for the overall development of the market.

4.2 The term "impact investing" was coined in 2007 through an initiative coordinated by the USA's Rockefeller Foundation 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, organisations, 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 defines the practice of impact investing by the following four core characteristics:

- *Intentionality* – The intent of the investor to generate social and/or environmental impact through investments is an essential component of impact investing.

- *Investment with return expectations* – Impact investments are expected to generate a financial return on capital and, at a minimum, a return of capital.

- *Range of return expectations and asset classes* – Impact investments generate returns that range from below market (sometimes called concessionary) to risk-adjusted market rate.

- *Impact measurement* – A hallmark of impact investing is the commitment of the investor to measure and report the social and environmental performance and progress of underlying investments.

(GIIN, 2014)

4.3 The term social investment was established in 2000 by the UK's Social Investment Taskforce and was more traditionally used in Europe until recently. In 2013, following the G8 Social Impact Investment Forum hosted by the U.K., the SIITF and others involved in the international process that followed began using the term social impact investment, defined as investments made into businesses and social sector organisations, directly or through funds, with the intention of generating a measurable, beneficial social and environmental impact alongside a financial return (SIITF, 2014a).

4.4 Essentially the terms – impact investing, social investment and social impact investment – mean the same thing. For the purposes of this paper and the OECD research, which has also been part of the international social impact investment initiative, the term social impact investment is used.

4.5 At this early stage of development in the market, many players prefer to keep the definitions broad, also as a way to engage more people in the market. However, 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 of what is considered social impact investment – and what is not. This chapter therefore seeks to deepen the discussion about social impact investing to provide a framework identifying what might or might not be considered to be SII.

4.2. Definitional Characteristics, Attributes and Eligibility

4.6 While there is a growing consensus about the broader framing of social impact investment, there is significant debate about the definitional scope of SII. This section seeks to provide a framework for working towards a SII definition by focusing on a set of defining characteristics and attributes as well as raising questions about possible eligibility boundaries. The goal is to allow enough flexibility for the consideration of various forms of SII, while helping to clarify what might be considered to be in or out of the commonly understood meaning of SII.

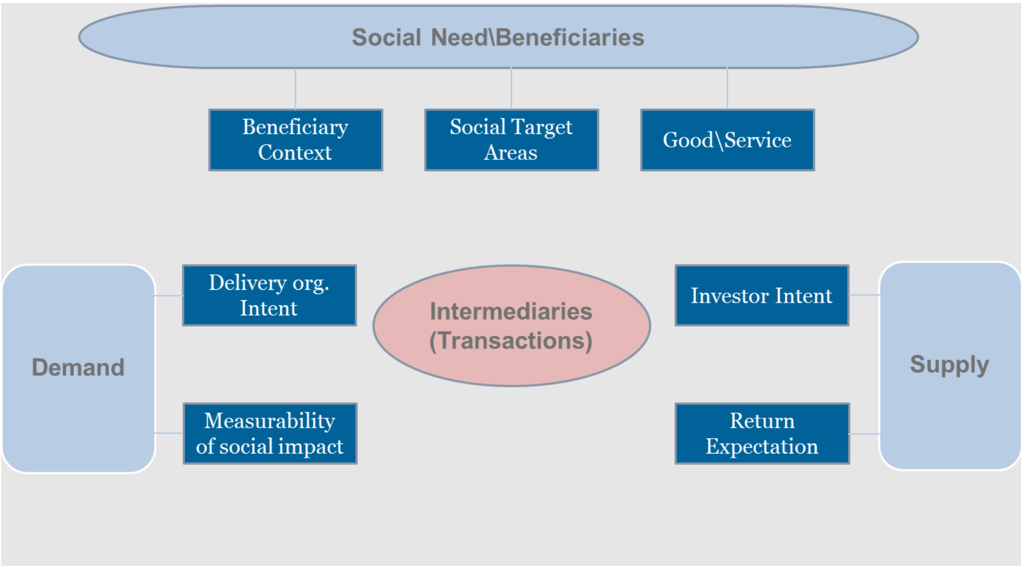
4.7 A number of characteristics can be used to describe a transaction and to classify it as either corresponding to SII or not. We have identified seven key characteristics (dark blue boxes in Figure 4.1 below) which are described further in the subsequent subsections.[7] A chart of all attributes and possible eligibility boundaries for each characteristic is provided in each of the corresponding sections below and then consolidated at the end of this chapter.

4.8 The characteristics are grouped according to the SII framework components described earlier. For example, while return expectations are identified at the investor level, the measurement of social impact is typically carried out by delivery organisations. Transactions are at the centre and are the units of assessment.

7 . Other characteristics could possibly be used. However, these seven characteristics are necessary and sufficient to: i) identify the SII "space" in the economy; ii) cover all SII players (and the profiles) relevant for a definition and iii) discuss the scope for policy action.

Figure 4.1. List of characteristics

In dark blue boxes, grouped by SII component



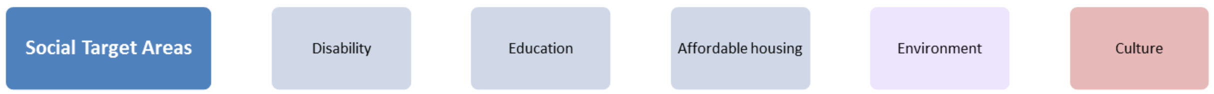
Source: OECD.

4.9 Within each characteristic, suggested boundaries could help to address the variability in the definition (which attributes are in and out). It is important to note that while some characteristics have attributes that can be quantified (e.g. return expectation), others have attributes that are discrete in nature distinguishing between different classes (e.g. different social target areas). Some fall in between the two, with different classes that can be "rank ordered" (e.g. investor intent). When attributes are quantified or can be ordered, thresholds are used to decide upon what is within the scope of SII. When no ordering is possible, deciding upon what is SII or not requires selecting the eligible attributes (or "buckets") that fit within the criteria for SII.

4.10 Figure 4.2 below provides two examples of characteristics, their attributes and the eligibility conditions. In the case of Social Target Areas, setting the eligibility boundaries means deciding which "buckets" are in (e.g. Education, in light blue) and which are out (e.g. Culture, in light red). With regards to return expectations, potential thresholds are also depicted in Figure 4.2 by black bars indicating that a transaction is only considered SII if returns are *expected* to be at least return of capital (black bar on the left), with an *expected* return that does not exceed the market rate of return (black bar on the right). Using this approach, investments can be classified as SII by comparing them against each characteristic and the related set of attributes and eligibility boundaries, based on a perspective of what should or should not be considered SII for each of the dimensions.

Figure 4.2. Defining Characteristics, attributes and eligibility

4.2a. Social Target Areas



4.2a. Return Expectation

Notes: The figure depicts two defining characteristics in dark blue: Social Target Areas and Return Expectation. Attributes are in light colour. Attributes in social needs provided here are examples and not an exhaustive list of all possible social needs. While returns on investment are continuous, social needs are discrete and can be thought of in terms of "buckets". Social Target Areas may overlap, but are considered here as discrete for the sake of simplicity.

Source: OECD.

4.11 While all of the characteristics are necessary, none of them are sufficient to define SII on their own. A transaction can be considered SII only if it meets the suggested eligibility boundaries for each of the seven characteristics. Accordingly, an investment can be classified as SII if, for every characteristic, it pertains to an eligible class for those characteristics which are discrete in nature, and passes the threshold for those characteristics which can be quantified or ranked.. Most importantly, these eligibility boundaries can be adjusted according to context and perspectives. For example, researchers may use a set of eligibility boundaries for data collection purposes, while a policymaker may find another set more useful for policy instrument design purposes. In addition, OECD countries may use one set of boundaries for thinking about SII while developing countries might use another. As a result, this approach allows for variation in the boundaries of SII that accommodate different purposes for defining SII. It is also important to note that some characteristics will be more relevant depending on the context and objectives of defining SII.

4.12 As an example, if a country decides that it should introduce a tax break for social impact investments, the practical question is to decide who is eligible for such tax break. In the UK, with the recent introduction of the Social Investment Tax Relief, the boundaries were set by legal structure and size (based on employees and assets): "Charities, community interest companies or community benefit societies carrying out a qualifying trade, with fewer than 500 employees and gross assets of no more than GBP 15 million may be eligible" (HMT, 2014).

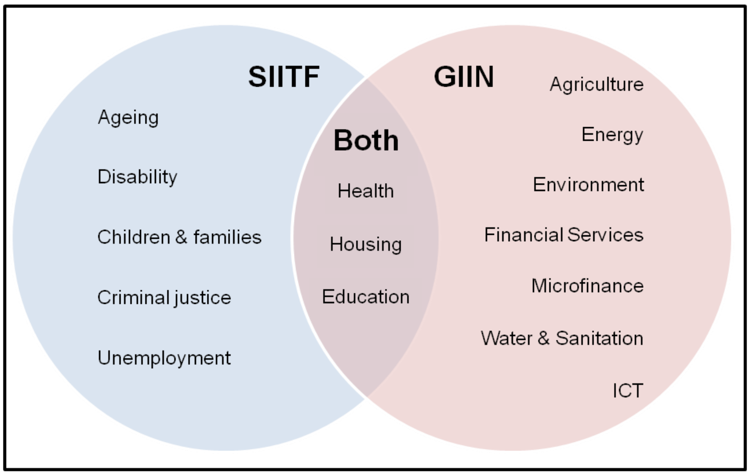
4.13 Different views exist in terms of where the boundaries lie for SII. This approach helps to explain these differences, while operationalising definitions for practical purposes such as data collection or policy implementation. Bringing all characteristics together, it is possible to devise a framework for setting clear boundaries according to the different perspectives and definitional purposes. The following sections discuss each defining characteristic in further detail.

4.2.1. Social Target Areas

4.14 Social target areas include a myriad of social needs in which SII can be put to work. Depending on the context, these can range from social needs, such as disability and unemployment to more traditional sectors, which applied in a certain context (see section 4.2.2) can have a high social impact.

4.15 Views on social areas to include in SII can vary according to the different perspectives of the players involved in each transaction. For example, the SIITF, which during the first year included only developed countries, focused on social issues while organisations operating in developing countries may take a broader view. GIIN is a global network seeking to attract mainstream investors to SII so for both of these reasons, they tend to categorize target areas in line with more traditional investment sectors. Figure 4.3 below provides a comparison of the social areas focused upon by the SIITF with the sectors outlined by the GIIN for global investors and intermediaries. Surprisingly, only three areas overlap (health, affordable housing and education), which illustrates how broadly perspectives can differ.

Figure 4.3. Social needs and investment sectors



Source: OECD based on Social Impact Investment Task Force established by the G8 and GIIN website, http://www.thegiin.org/, accessed 21 July, 2014.

4.16 Table 4.1 below provides a range of social areas that could potentially be considered SII under various circumstances. The first three areas include Community, Culture and Arts, which have typically been covered by philanthropic grants. The last five include Agriculture, Energy/Environment, Financial Services, Water and Sanitation, and ICT, which can be considered more mainstream investment sectors. Therefore on both of these ends of the spectrum, inclusion as SII depends on the other characteristics of the transaction, which will likely vary by subsector or location of provision of the service (described further in section 4.2.2 below).

4.17 Dementia is an example of a social need in which SII can play an important role — this is clear from the G8 initiative launched in this area last year by the U.K. Active Minds (UK), which provides products and activities that help people suffering from dementia, is an example of an organisation into which investment could clearly be considered. On the other hand, the Big Idea Cooperative (US) is a café and bookstore that focuses on reaching out to the community and selling books promoting "social, economic and environmental justice". It is a certified B-corp, incorporated as a limited liability company (LCC) and running on a not-for-profit basis. However, while providing books (literature) can be considered "culture", it is not clear that this organisation would fit within most SII definitions (including OECD) as it does not set outcome objectives and measure their achievement.

Table 4.1. List of attributes for Social Target Areas

CHARACTERISTICS	Attributes of the Characteristic		Eligibility*
1. Social Target Areas	Typically Philanthropy	Community Culture Arts	
	Core SII areas	Ageing Disability Health Children and Families Public order and Safety (Affordable) Housing Unemployment Education and Training	IN IN IN IN IN IN IN IN
	Other areas, leaning towards mainstream	Agriculture Environment and Energy Water and Sanitation Financial Services (incl. Microfinance) ICT	

* Eligibility used in the OECD definition for the purpose of this report. The areas not clearly listed as being core SII are context dependent (see section 4.2.2).

Source: OECD.

4.18 It should be noted that there is often a degree of overlap between social areas. Not only can issues cut across various social areas, but actions in one area can have an impact or spillover into other areas. Chapter 5 discusses social issues and their implications in further detail and also points to examples such as the intersection between health and ageing areas.

4.2.2. Beneficiary context

4.19 As discussed in the section above, some investment activity might target areas that would not fit within the typical SII. However by addressing the needs of populations at risk or those living in underserved or developing areas, regions or countries, some of those transactions might be considered to be SII (Table 4.2 below). Financial services can be used as an example. In developing regions, in which access to financial services may be limited, providing financial services in economically disadvantaged areas, with eventual returns on investments would be considered SII as these investments can lead to improvements in the living conditions of the population. While some of these types of investments may be considered in the sphere of development finance, they can also be considered to be in a broader definition of SII.

4.20 The same principle applies to IOT, an agriculture company whichbreeds sea cucumbers in Madagascar and one of the portfolio companies of Investisseurs and Partenaires, a SII intermediary (see WGIM, 2014).[8] While such a business would not be considered SII if operating in developed countries, the social dimension arising from the contribution to the fight against hunger and through the improvement of employment and living conditions for local populations, means it could be considered to meet SII criteria.

8 . Further information can be obtained through I&P's website, available at: http://www.ietp.com/entrepreneurs_en/#profil

Table 4.2. List of attributes for Beneficiary Context

CHARACTERISTICS	Attributes of the Characteristic			Eligibility*
2. Beneficiary context	Population *at risk*			IN
		Social Demographics:	Age Family type Other	
		Location:	Underserved Developing Developed	
		Income		
	Population *not at risk*			OUT

* Eligibility used in the OECD definition for the purpose of this report.

Source: OECD.

4.21 In terms of populations at risk, family type, age (life cycle needs) and other social demographics can result in social exclusion of some people. This occurs not just because of income and wealth factors, but also due to the combination of socio-demographic risks that may result in costly social exclusion if not managed or supported properly. Therefore, identifying whether populations are at risk of social exclusion due to social demographics also helps determining whether the beneficiary context falls within the scope of SII. For the purposes of the OECD definition, SII should target populations at risk.

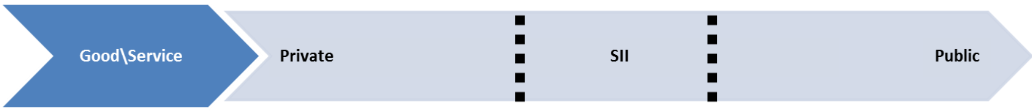
4.22 While providing affordable housing for populations at the risk of social exclusion (or *de facto* socially excluded) can have a social impact (e.g., accommodation for people that live on the streets), affordable housing that targets well-off people may improve the living conditions of the beneficiaries but not necessarily address social needs such as reducing homelessness figures. In London, a social impact bond (SIB) that aims at providing accommodation for "rough sleepers" is currently in place (see Chapters 3 & 7 for further detail on SIBs) and would fit within most SII definitions.[9]

4.2.3. Good\Service

4.23 The type of the specific good or service (hereafter referred to as "good") being provided, either pure private, pure public, or mixed, is relevant to understand whether there is a market for SII. Only the two extremes (public and private) are provided in Table 4.3 for simplification. While on one extreme, a good can be classified as "public", on the other extreme it can be classified as a "private". SII eligibility will apply to goods within the continuum between the two boundaries as illustrated, for example, by the dotted black lines in Figure 4.4 below.

9 . Further information on the London "rough sleepers" SIB can be found at: https://www.london.gov.uk/priorities/housing-land/tackling-homelessness-overcrowding/rough-sleeping/social-impact-bond-for-rough-sleepers

Figure 4.4. Degree of Publicness



Source: OECD.

4.24 Social goods have different characteristics than pure private or public goods insofar as they would not completely exclude benefits accruing to non-target beneficiaries, but there are barriers which limit the opportunities for non-target beneficiaries to access the good without incurring any additional cost (important for the profit-principle). On one hand, goods and services that are excludable could more efficiently be provided under a fully private model. On the other hand, goods and services for which it is very difficult to exclude potential beneficiaries tend to be provided under a public delivery approach. In a list of SII attributes, each social good or service can be categorised according to its “degree of publicness" (see table 3).

Table 4.3. List of attributes for Good\Service Characteristics

CHARACTERISTICS	Attributes of the Characteristic		Eligibility*
3. Good\Service	Degree of publicness	Public	OUT
		(SII)	IN
		Private	OUT

* Eligibility used in the OECD definition for the purpose of this report.

Source: OECD.

4.25 The practical use of this attribute for defining SII goods is to some extent limited, because it is challenging to accurately measure the “degree of publicness” of a good\service and fully identify the scope of the spillover effects of providing such good\service. However, this characteristic is crucial for devising policy because while a fully public good should be provided within a public model, private goods should be left for the private initiative, without any intervention of public sector authorities beyond acting upon the regulatory side.

4.26 The hybrid nature of some social goods\services might require some forms of public-private collaboration, in which some SII-like models of provision fit. The decision of whether a good is public or private or semi-public will be left to policymakers.

4.27 Table 4.4 depicts a matrix that provides a framework for further clarifying why the SII approach should be defined as between the pure public and pure private models of provision. The table builds on the expectation of SII to produce social benefits, and measures these as social outcomes (the two rows distinguish social impacts at the individual and society levels) and cost benefits, or efficiency gains (the two columns distinguish economic efficiency at the individual level from systemic/society efficiency gains).[10]

10 . Please note that these should not be regarded as dichotomous but rather as vectors flowing from the individual to the societal\systemic levels. There is also a parallel deliberately implied here with spillovers and externalities as well as with macro and micro impacts.

Table 4.4. Social Returns and Economic Efficiency

Impacts at the individual or societal\systemic level

Degree of publicness	Individual efficiency gains	Systemic efficiency gains
Social impact on the individual	PRIVATE	Possible SII
Social impact on the society	Possible SII	PUBLIC

Source: OECD.

4.28 Two levels of "Social" are defined here: 1) the provision of goods that address the social needs of an individual or society to improve life outcomes (social impacts); and 2) the provision of goods that result in savings in the costs or improvements in the effectiveness of providing for social need (efficiency gains). The provision of goods that have no social impact is not discussed here, as they are screened out in the discussion of Social Target Areas.

4.29 Where the consumption of a good has a social impact at the individual level only (very limited spillovers) and does not result in meaningful systemic efficiency gains these are considered 'private' – as the benefits/costs of the consumption is limited to the individual alone. Where the consumption of a good has both a social impact on society as a whole and result in systemic efficiency gains these are considered 'public' – as their consumption is in the broadest social interest, as well as the potential for 'free-riders'.

4.30 Where the consumption of a good has only individual efficiency gains, but there are social returns to the society as a whole there may be space for SII; this would be the case for lowering the cost of consumption for 'social impact' private goods at the individual level – such as affordable housing.[11] Where the consumption of a good creates social impact primarily at the individual level but also results in systemic efficiency gains (e.g. lowering recidivism rates, to reintegrate offenders and lower costly prison budgets) there is also potential for SII.

4.31 When the consumption of a good favours individual efficiency, but has broader social returns, it is important that any social impact spillovers are correctly factored in the SII instrument (e.g. through the use of SIBs). The consumption of affordable private goods with broad social impacts is clearly desirable, but nonetheless challenging for private enterprise models because the incorporation of externalities and monetisation of outcomes into businesses objective function is not always straightforward.

4.32 The Social Impact Bond (SIB) model is based on a "pay for success" feature that allows setting outcomes (and objectives for providers and investors) that take into account externalities. This model is described in detail in Chapters 3 and 7. As an example, the Development Impact Bond (DIB) addressing malaria in Mozambique has a clearly defined outcome measure - reducing incidence rates by at least 30%. The approach is to provide anti-mosquito nets and indoor spay to at-risk populations. By focusing on incidence rates, the DIB incorporates not outputs at the level of non-affected individuals, but also a systemic health issue.

11 . In the U.K., the percentage of the population living in households where the total housing costs (net of housing allowances) represent more than 40% of disposable income (housing cost overburden rate) was almost 41%, well above the EU average of 25% (OECD, 2013c, pp. 61).

4.2.4. Delivery organisation intent

4.33 The intent of delivery organisations can be an important characteristic in defining SII even though it is not straightforward to operationalise due to the subjective nature of the implicit attributes. A possible approach is to build on verifiable demonstrations of social intent. The intent of delivery organisations, as well as investors (discussed in a following section) is subjective and challenging to capture.

4.34 Social intent can vary from an incidental outcome (i.e. whereby a social outcome is attained despite the fact that there was no intent beforehand) to a legally binding objective (Table 4.5 below). While difficult to identify precisely, the intermediate levels in this case might be disentangled, in particular by looking at the organisation's mission and vision. Having the intention to address social challenges might not be sufficient for a social venture to be considered to be eligible for SII. For the purposes of the OECD definition, merely having the intent stated on the mission is not enough to be considered SII as the delivery organisation must put sufficient effort into demonstrating that they are committed to the social cause.[12]

Table 4.5. List of attributes for Delivery Organisation Intent

CHARACTERISTICS	Attributes of the Characteristic	Eligibility*
4. Delivery organisation intent	Incidental Social outcome	OUT
	Social Mission Intent	OUT
	Compulsory reporting	IN
	(Seeks and obtains) External Certification or Label	IN
	Legally binding constraints	IN

* Eligibility used in the OECD definition for the purpose of this report.

Source: OECD.

4.35 A strong level of commitment can be demonstrated through some form of compulsory reporting of social outcomes to shareholders within the organisation's statutes. Within the work of the SIITF, the Mission Alignment Working Group has identified different degrees of impact intent: i) simply comply with minimum legal requirements to create impact; ii) intention to create impact and iii) a primary commitment to create impact (WGMA, 2014). Only the latter is considered to be within the scope of SII (social enterprises and "profit with purpose businesses").

4.36 A number of initiatives have focused on developing metrics for impact assessment as well as assigning labels to companies (see Chapter 6). These help to identify companies within the scope of SII because they provide a good indication of commitment to social issues. However, while not all SII-related companies will be certified as so, some certified companies may not fully correspond to a certain definition of SII. For example, B-Corp certifies companies based on a number of variables, some of which may be considered to go beyond SII, under a narrower SII definition.

4.37 Legally binding constraints provide the strongest indication of commitment to social goals. The Financing Agency for Social Entrepreneurship (FASE) in Germany helps social entrepreneurs raise money and, in the financing contracts managed by FASE, clauses are included in order to prevent social mission drift (WGMA, 2014).

12 . Please note that the combination of social intent expressed in the mission combined with, for example, a formal measurement and valuation of social impact should be duly considered

4.38 It is also important to distinguish "intent" from actions taken by companies to limit negative externalities arising from their business activity. The later should be considered Corporate Social Responsibility (CSR) and would not be included within SII.

4.2.5. Measurability of Social Impact

4.39 Just as with financial returns, SII investors require some form of measurement of social impact to factor both financial outcomes and social impact into their investment decisions (WGAA, 2014). This characteristic can range from the lack of measurement to formal evaluation with monetary valuations of social impact (see Table 4.6 below). Without having any form of social impact measurement a transaction cannot be considered SII.

Table 4.6. List of attributes for Measurability of Social Impact

CHARACTERISTICS	Attributes of the Characteristic	Eligibility*
5. Measurability of Social Impact	No measurement	OUT
	Informal evaluation, not valued	OUT
	Formal evaluation but not valued	IN
	Formal evaluation and valued	IN

* Eligibility used in the OECD definition for the purpose of this report.

Source: OECD.

4.40 Impact assessment can be carried out in a qualitative (e.g. "improved the healthcare provision"), quantitative (more robust analysis, e.g. "increased the number of patients treated that would otherwise would remain untreated") and\or by the monetisation of outcomes (e.g. attaching a value to the benefits for each treated patient as well as to the benefit to the society). It is important to attach a measure of the benefits (e.g. tangible changes in social outcome indicators or even in pecuniary terms) to impact measurement so that it is possible to understand if the workings of the delivery organisation and the investment have a *de facto* social impact.

4.41 The measurement of social impact is not straightforward, and difficulties associated with its elaboration resulted in the creation of a working group to focus on impact measurement within the process of the SIITF. The Working Group identified four main phases of the impact measurement process, hereafter "formal" impact evaluation process. First, planning requires agreement upon impact goals (including *a priori* selection of indicators) and the strategy to achieve them (see Chapter 5 for a discussion on selecting indicators). Second, building the evidence base includes collecting, storing and validating data. Third, the quality, level and efficacy of the impact are assessed based on the analysis of data gathered. Finally, the impact and the measurement process are reviewed, providing input to future improvements in impact measurement (WGIM, 2014).

4.42 In addition, a working group on impact measurement for social enteprises was created in the framework of the GECES, the European Commission's Group of Experts on Social Entrepreneurship, which released a report on "proposed approaches in European Commission legislation and in practice related to EuSEFs and the EaSI" (Clifford et al 2014).

4.43 Building on the results of these working groups and expanding the analysis to the policy dimensions of social impact measurement, the OECD (forthcoming 2015) underlined the importance of encouraging experimentation and further analysis of ongoing developments in social impact measurement by social enterprises. This could help to foster a social impact measurement culture among stakeholders. The issue of proportionality of measurement is also important. Measurement should only be done if, and to the extent that it will actually influence decision-making, and the cost of measurement is not excessive compared to the significance of that decision.

4.44 Evaluation processes are very challenging because ideally they require having a comparison group — i.e. what would have been the social outcomes if the delivery organisations would not exist. Given that running experiments and\or alternative empirical testing methodologies can be very resource intensive and require special skills, most intermediaries and companies do not take such an approach but rather use a mix of qualitative information with a range of quantitative indicators on social impact.

4.45 As an example, Investisseurs and Partenaires have a clear strategy for measuring impact (WGIM, 2014). Impact measurement does not follow an impact evaluation approach based on counterfactuals due to significant data challenges (and high costs of running experiments). Instead focus is given to impact data provided by investee companies. The impact assessment framework is nevertheless well developed (WGIM, 2014).[13]

4.46 Active Minds, briefly described above, reports the achieved social impacts on a yearly basis.[14] This report provides an overview of data regarding business activities (e.g. number of devices sold) and features the result of a survey conducted with 7% of their customers regarding the impact that the devices have had on the quality of care (for corporates) or on the life quality of dementia-suffering family members (for individuals). Even though such an approach is far from a formal and thorough assessment of social impact, it reveals awareness for the need to provide information on social impact.

4.47 The most comprehensive (but also challenging) approach to impact measurement requires a formal evaluation that also allows translating social impact into value. For example, the design of SIB contracts requires that predetermined social outcomes are attained before any payment is made by the contractor. This means that social impact needs not only to be measured but also to be valued in designing the "impact value equation" that balances the interests of outcome funders and investors (SIITF, 2014b).

4.2.6. Investor intent

4.48 Investors' social impact intent is also a characteristic that features in most SII definitions (e.g. GIIN, SIITF). As discussed above, clearly identifying intent is challenging.

4.49 On the one hand, investors can have a social impact even without having any social intent in the first place, if their investments happen to produce an unexpected or unintentional social outcome (incidental social outcome). For example, VantagePoint Capital Partners was awarded the 2013 financial investor in the cleantech industry. Investments in clean technologies create positive environmental impacts, but the main purpose of VantagePoint Capital Partners is to make profitable investments. Since there is no clear intent in achieving a social impact, such investments will not be considered as SII. Conversely, CANOPUS Foundation has been investing in solar power in Africa with a clear mission towards environmental sustainability.[15]

4.50 On the other hand, some investment contracts may formally require intentionality to achieve specified social outcomes. As an example, having a social intent may be compulsory under certain settings

13. Further information about Investisseurs and Partenaires is available at http://www.ietp.com/. The impact measurement report can be found at: http://ietp.com/our-esg-impacts-annual-report-online

14. The report can be retrieved from Active Minds website at: http://www.active-minds.co.uk/index.php

15. Further information about VantagePoint Capital Partners can be found at: www.vpcp.com Further information about CANOPUS Foundation is available at: www.canopusfund.org

— e.g. within a SIB structure, the government contractor will have specific payment terms that will depend on achieved outcomes, thus requiring a legally binding social intent. Accordingly, investor intent will range from incidental outcome (which is not included in SII) to legally binding constraints (which are included).

4.51 In between these two extremes, varying levels of intent can be observed (see Table 4.7 below). For example, social intent may be expressed in a statement or other document regarding the investment made or investor profile. Citizen Capital is an investment fund that clearly states its intent to invest in social businesses and labels itself as an *impact investing* fund. The attainment of social goals is expressed in the vision as well as in a set of investment criteria that go beyond financial aspects (e.g., "investing in disadvantaged areas"; "addressing the needs of vulnerable populations").[16]

Table 4.7. List of attributes for Investor Intent

CHARACTERISTICS	Attributes of the Characteristic	Eligibility*
6. Investor intent	Incidental Social outcome	OUT
	Social intent expressed in statement	OUT
	Compulsory reporting	IN
	Legally binding constraints	IN

* Eligibility used in the OECD definition for the purpose of this report.

Source: OECD.

4.52 Foundations also have a clearly defined social mission both in statutes, as well as by legal requirements related to legal status. Some foundations have increasingly focused on SII approaches as a way to tackle social issues (Rangan et al, 2011). For example, as discussed earlier, the Gates Foundation makes Program Related Investments (PRI) in a wide variety of social areas such as education (e.g. Civic Builders), health (Global Health Fund, BiologicalE Vaccines).[17] PRI investments, which can involve a mix of instruments including debt and equity, aim to tackle social issues targeted by foundations while potentially generating some financial return.

4.2.7. Return expectation

4.53 Return expectations for investors are an important characteristic for defining the scope of SII. This characteristic is considered in most definitions being used in the SII market. In particular, there has been considerable debate regarding the risk-return profiles of SII (see WGAA, 2014). It is still unclear where the lower and upper bound of returns should stand in terms of considering an investment as SII. The last column of Table 4.8 below depicts the OECD approach to this issue. Donations stand at one of the extremes, in the sense that there is no expectation of getting part of the money back. As noted earlier, this is philanthropy and clearly cannot be considered as "investment".

16. Information on Citizen Capital can be found at: http://www.citizencapital.fr/

17 . Further information available at: www.gatesfoundation.org/how-we-work/quick-links/program-related-investments.

Table 4.8. List of attributes for Risk Adjusted Return Expectation

CHARACTERISTICS	Attributes of the Characteristic	Eligibility*
7. Return expectation	Grants	OUT
	Return of Capital	IN
	Profit =< market RR	IN
	Profit > market RR	OUT

* Eligibility used in the OECD definition for the purpose of this report.

Source: OECD.

4.54 At the other extreme, are *expectations* of profits above the market risk adjusted rate of return. On the one hand, investments made with the purpose of exceeding risk adjusted market rates of return would be no different from the mainstream for-profit market, thus not considered SII for the purpose of the working definition. On the other hand, effective rates of return on SII may turn out to be as high, or in some cases, higher than market rates of return. It is important to note, however, that investors expecting a return above risk adjusted market rates indicate that they regard such an investment to be no different from a mainstream for-profit investment and therefore it should fall outside the scope of SII. As noted earlier, rates of return vary across social sectors, and would also be taken into consideration by investors. Of course, the main issue is defining the "market rate of return" for social impact investment. To some degree, this characteristic is therefore a matter of principle in terms of the intention of the investors.

4.55 The profit distribution policy of companies can be a determinant of whether a certain flow can be considered as SII. The discussion of this characteristic has stirred significant debate — in particular, on the extent to which social enterprises should be defined by reinvesting their profits (e.g. Galera & Borgaza, 2009). Some degree of profit distribution might be needed to guarantee that investments yield positive returns. The extent to which social businesses are able to redistribute profits is also dependent upon their legal structure. For example in Italy, the legislation on social enterprises is currently being reviewed to, amongst other aspects, allow social enterprises to distribute profits (WGMA, 2014 and NAB-ITA, 2014).

4.3 OECD working definition of SII

4.56 For the purposes of this report, the OECD has sought to draw some initial eligibility boundaries for each of the core characteristics of SII. A summary of these suggestions is listed in the table below and in the draft OECD working definition of SII.

OECD Working Definition of SII:

Social Impact Investment is a transaction between an investor and investee in a social area, targeting beneficiaries in need. Beneficiaries targeted should be at risk populations and the good provided should have a mix of public and private good characteristics. These transactions are often made using intermediaries. The investee in the transaction should, at least, inscribe a compulsory reporting clause of its social activity in the statutes, as well as provide a formal evaluation of social impact. In parallel, the investor should, at least, have a compulsory reporting clause for social impact investments and have return expectations above or equal to zero, but not above the market rate of return (actual return may be higher).

4.57 As discussed earlier, while all of the characteristics listed in the chart below are necessary, none of them alone are sufficient to define SII. A transaction can be considered SII only if it meets the defined eligibility boundaries for each of the seven characteristics.

List of characteristics, attributes and eligibility

CHARACTERISTICS	Attributes of the Characteristic			Eligibility*
1. Social Target Areas	Typically Philanthropy	Community Culture Arts		
	Core SII areas	Ageing Disability Health Children and Families Public order and Safety (Affordable) Housing Unemployment Education and Training		IN IN IN IN IN IN IN IN
	Other areas, leaning towards mainstream	Agriculture Environment and Energy Water and Sanitation Financial Services (incl. Microfinance) ICT		
2. Beneficiary context	Population *at risk*			IN
		Social Demographics:	Age Family type Other	
		Location:	Underserved Developing Developed	
		Income		
	Population *not at risk*			OUT
3. Good\Service	Degree of publicness	Public		OUT
		(SII)		IN
		Private		OUT
4. Delivery organisation intent	Incidental Social outcome			OUT
	Clear Social Mission Intent			OUT
	Compulsory reporting			IN
	(Seeks and obtains) External Certification or Label			IN
	Legally binding constraints			IN
5. Measurability of Social Impact	No measurement			OUT
	Informal evaluation, not valued			OUT
	Formal evaluation but not valued			IN
	Formal evaluation and valued			IN
6. Investor intent	Incidental Social outcome			OUT
	Social intent expressed in statement			OUT
	Compulsory reporting			IN
	Legally binding constraints			IN
7. Return expectation	Grants			OUT
	Return of Capital			IN
	Profit =< market RR			IN
	Profit > market RR			OUT

* Eligibility criteria used in the OECD definition for the purpose of this report.

Source: OECD.

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5. CONTEXT SETTING: DIFFERENCES IN SOCIAL NEEDS AND SERVICE DELIVERY ACROSS SELECTED COUNTRIES

This chapter looks at the context for social impact investment across the G7 and Australia. This includes looking at changes in social needs and direct public sector provision over time as well as a discussion of the different models of social service provision in each country. This chapter covers: a review of trends in social needs in key service sectors (health, employment and education, housing, criminal justice and family services); trend changes in public spending in the above areas; models of social services provision; evidence of best practice in this area; and, methods and issues for measuring social impact.

5.1 Introduction

5.1 The contexts in which Social Impact Investment (SII) takes place, country-to-country, will have a significant bearing on the potential for SII to have a lasting and positive role in society. Key contextual factors include: the extent to which present legislation and financial regulation plays a role in facilitating social impact investment; the extent of social need by sector; the evolving size and role of public intervention, also by sector; varying models of social service provision in each country, stakeholders and their present effectiveness; and, the political economy of private intervention.[18]

5.2 The variation in these contexts can inform how different SII approaches may be more appropriate in some sectors than in others, and easier to implement in some countries than in others. The purpose of this chapter is to contribute to the discussion of how SII could fit in to present forms of social impact investment by mapping key social-contextual factors in the G7 and Australia.

5.2 Social outcomes and social spending

5.3 The space in which SII could take a positive role in social development provides further contextual information for assessing the need for SII, and its likelihood to have a meaningful and lasting effect. *Understanding how different countries achieve preferred social outcomes, relative to the extent of public social interventions, is important for gauging this 'SII market space'.* Of course, the final 'market space' will also be determined by the extent to which SII might want to go 'above and beyond' the public efficiency and effectiveness, but because governments are the largest investor in social causes in every country, the specific role of public spending relative to key social outcomes is the most appropriate starting point for such an estimate.

5.4 Below, two sections will discuss trends in social outcomes and public expenditure from across a range of social sectors, with a focus on what these data might mean for SII.

18. Historical factors also play a role, but are beyond the scope of this paper.

5.2.1 The need (for better) social services: trends in social outcomes

5.5 The extent to which any investment can make a social impact will rely on the type and extent of need – and demand for improvement – across an array of social outcomes. Social outcomes are evolving in different directions, in different social sectors, for different reasons – and social services can take a supporting role in both positive and negative settings. For instance, increasing life expectancy and ageing societies increase demand for long-term care of various kinds (frailty, dementia, in-home or institutional care), whereas the increase in single-parent families or families in which both parents work will need to be facilitated by family care services in preschool and after-school.

5.6 The following subsections provide some examples of evolving needs in health, employment and activity (including education), housing, public order, and family service sectors.

5.2.1.1 Health and care needs of the elderly

5.7 Although there are many health outcomes and services to consider across the population, the long-term health care needs of the elderly are of particular interest for the SII discussion for two reasons. First, the health of the elderly is an important social consideration as societies age, and people live and work longer. Second, because it is here where the highest voluntary private social spending occurs because of the intersection of health and old-age spending (OECD, 2014a).

5.8 Figure 5.1 reports on the extent of social need for elderly care, and predictions for social need in the future. Panel A maps the rates of people aged 65 years receiving long-term care at home or in institutions (bars), and plots over these figures the prevalence of dementia among the population aged 60 years and over. The demand for elderly long term care (LTC) in OECD countries is high, with 1 in 8 people over 65 receiving LTC, two-thirds of whom are receiving this care at home. Long-term care needs are determined by health needs, and so by using the example of dementia – a concern for old age in particular, resulting in progressively high-intensity health and care supports – it can be estimated that at least half of LTC receivers over 60 will need some high-intensity services at some point in their lives.[19]

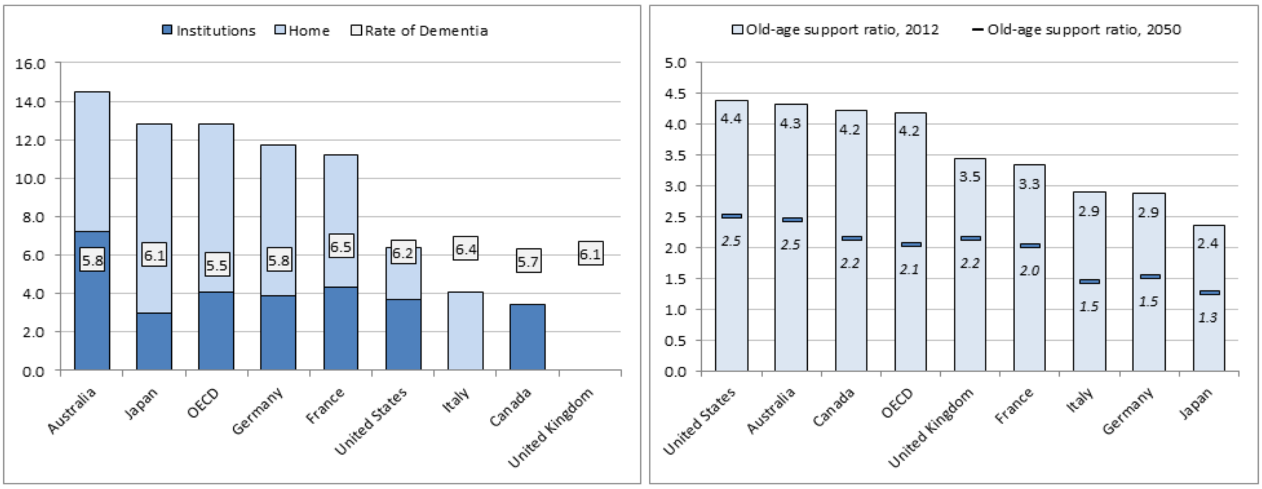
5.9 The juxtaposition of the figures in Panel A, read alongside the evidence in Panel B, gives the strongest message for the need for innovative social delivery organisations in these countries. First, although LTC provision varies widely, the demand for these provisions is likely to be very similar across countries – and so there is unmet demand. Second, as the scale of dependency increases, demand for care will increase substantially relative to the working-age population in the coming decades.

19 . As noted earlier in the paper, the G8 has put a special spotlight on the issue of dementia and has been investigating the role that SII can play in helping to address this growing social concern.

Figure 5.1: One in 20 over 60's have dementia, on average one in 8 over 65's are subject to long-term care, and in the next 30 years rates the support ratio for older people will halve

Panel A: Population aged 65 years and over receiving long-term care, 2011 (or nearest year) and prevalence of dementia among the population aged 60 years and over, 2009

Panel B: Over 65 population as a ratio of working age population (15-64)



Note: For long-term care estimates, data is missing for the United Kingdom, and is for different dates in other countries (Japan (2006), United States (2007), Canada (2009), and France (2010)). The long-term care OECD average is for 21 countries (see online data annex). For prevelance of Dementia, OECD average is for 34 countries.

Source: OECD Health Statistics 2013 (OECD, 2013d), (http://dx.doi.org/10.1787/health-data-en and citing Wimo et al [2012] for dementia estimates) and Society at a Glance, (OECD, 2014b).

5.2.1.2 Unemployment, inactivity and school drop-outs

5.10 Helping people into good quality and secure employment is critical for a range of desirable social outcomes today and in the future. Today, the private and public social gains from employment include a reduction in household poverty – and the improved quality of life this brings – increases in productivity, and reductions in benefit dependency. For tomorrow, employment is critical for building the social contributions needed to pay for a person's own pension and elderly care, as well as for tax contributions that fund much of the present public social spending in the areas of health, education, and social protection among others. Helping youth into quality employment or stay in education settings is the foundation for success in this area, as well as a healthy economy and society.

5.11 Table 5.1 presents experiences of long-term unemployment spells, unemployment rates for older workers, education drop-out rates for older youth, and rates of inactivity in youth (NEET – "not in education, employment or training") in younger and older cohorts. Percentage point movements up or down in the past five years are presented in parentheses, where available. Altogether, the data highlight need, and to a degree a lack of effective policy development, in present social 'activation' systems: two factors which would indicate demand for SII-type innovation in this sector.

5.12 More specifically, many country systems are struggling to produce effective employment or 'activation' outcomes in older youth cohorts, and, with the exception of Germany, people who are unemployed are facing much greater challenges in returning to work now than they did 5 years previously (Italy and Japan have notable challenges to contend with here, and across the OECD as a whole the rate of longer term unemployment has increased by 50% in 5 years).

Table 5.1: Although younger and older cohorts have experienced little change in unemployment risks, more unemployed people are out of work for a year or more

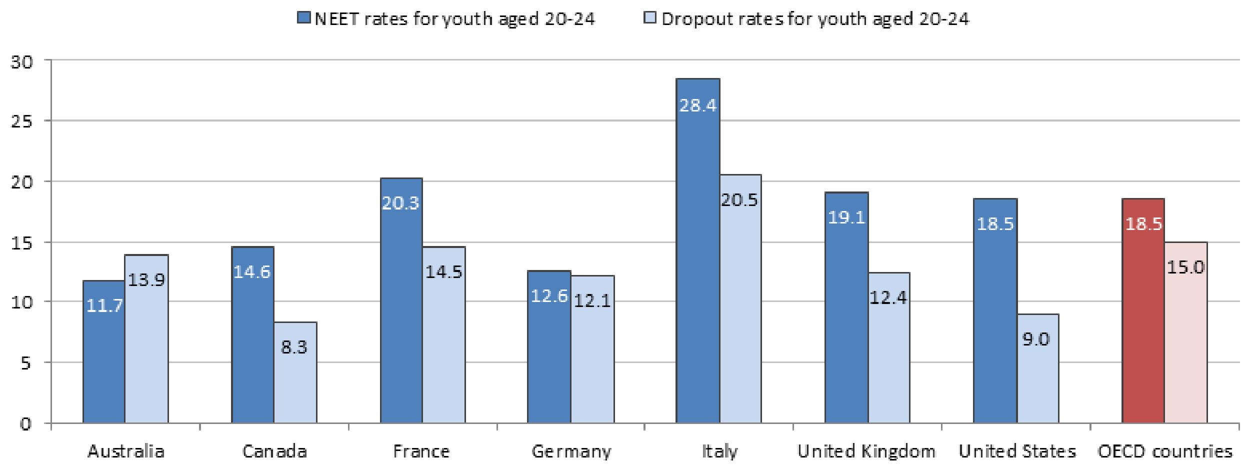
	Long-term unemployment (2013)	Unemployment (55 to 64 years, 2013)		Dropout rates for youth aged 20-24 (2011)	NEET rates (2011)	
		Male	Female		15-19	20-24
Australia	19.2 (4.4)	4.3 (0.6)	3.2 (0.3)	13.9	7.8 (1.4)	11.7 (1.0)
Canada	12.7 (4.9)	6.9 (-1.1)	5.8 (0.1)	8.3	7.7 (0.5)	14.6 (0.9)
France	40.4 (5.1)	7.5 (1.1)	6.5 (0.5)	14.5	7.1 (0.8)	20.3 (2.4)
Germany	44.7 (-0.8)	6.2 (-1.8)	5.3 (-2.8)	12.1	3.5 (-0.7)	12.6 (-2.7)
Italy	56.9 (12.5)	6.7 (2.9)	4.1 (1.4)	20.5	11.4 (1.2)	28.4 (5.8)
Japan	41.2 (12.7)	4.4 (-1.0)	2.8 (-0.5)	…	10.1 (2.5)	…
United Kingdom	36.3 (11.8)	5.4 (-0.5)	3.8 (0.9)	12.4	9.5 (-1.2)	19.1 (1.1)
United States	25.9 (9.7)	5.6 (-1.5)	5.0 (-1.0)	9.0	7.1 (0.8)	18.5 (2.3)
OECD countries	35.3 (11.6)	6.1 (-0.1)	5.0 (0.0)	15.0	8.2 (0.1)	18.5 (2.4)

Note: Employment figures are rates in given years, figures in parentheses record the difference in the rates compared to 5 years previously. Dropout rates are for the share of 20-24 year-olds having left school and not holding an upper secondary degree.

Source: OECD dot.stat employment and education series, 2014c, OECD 2014d.

5.13 Educational dropout rates also represent a variable challenge across countries and a predictor of hard-to-place inactive youth; preventing dropouts from education is realistic and measureable intervention space for SII, with as many as 1 in 7 older youth not leaving school with only a lower-secondary. Figure 5.2 maps the NEET rates for older youth to the dropout rates, and shows that in all cases, with the exception of Australia, it is unlikely to be low education alone that inhibits the activity of youth as NEET rates outstrip drop-out rates. In Canada, Italy, the United Kingdom and the United States the difference might suggest an unmet demand for services to place qualified youth into work.

Figure 5.2 Australia has the most success in activating low skilled youth



Note: Both series are for 2011. Data for Japan are missing. Dropout rates are for the share of 20-24 year-olds having left school and not holding an upper secondary degree.

Source: OECD dot.stat education series, 2014c, OECD 2014d.

5.14 In the area of employment support, a number of countries are encouraging SII through the introduction of Social Impact Bonds (SIBs), including one to reduce youth unemployment in the United Kingdom, see Chapter 5 for details.

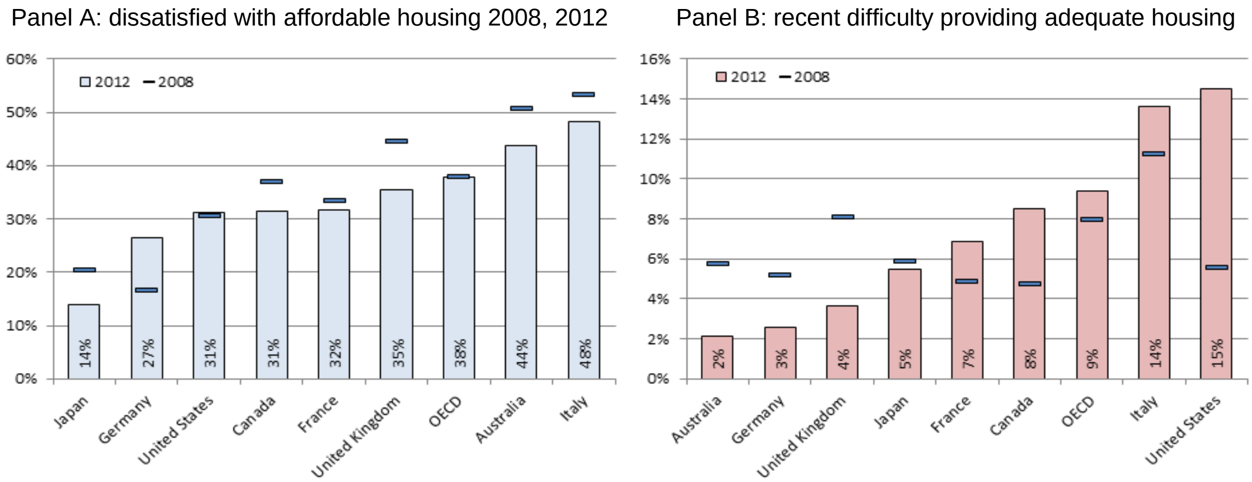
5.2.1.3 Housing affordability and quality

5.15 A further sector related to important social outcomes is housing. Providing all members of society with a secure and good quality accommodation is not only a human right and an ethical priority, but stable good-quality homes provide the foundation from which stable employment is achieved, families are formed, communities are built, local environments are protected, and social cohesion can develop.

5.16 Figure 5.3 presents two panels of housing data from the Gallup World poll and shows overall, that while there has been some falls in the rates of dissatisfaction with housing options over recent years, these have generally been from high levels (on average over 1 in 3 respondents in the OECD reported dissatisfaction with the level of good quality affordable housing in the city or area where they lived). At the same time, respondents also reported an increase in experiences of being unable to meet hosing costs.

5.17 Across the OECD, almost one in ten people have trouble meeting housing cost at some point in the year, in Australia this is now as low as 1 in fifty, and nearer 1 in 7 in the United States (where the financial crisis would have had an effect). The message for SII is that there remains high demand for affordable housing in most countries, as well as for services to improve the quality and affordability of present housing stock (although to a lesser extent).

Figure 5.3: Satisfaction with affordable housing increased in recent years, but experiences of difficulty in meeting costs also increased



Note: The Gallup World Poll was conducted by telephone in approximately 140 countries in total, and all OECD countries, using a common questionnaire translated into the main national languages. Samples are nationally representative of the resident population aged 15 and over in the entire country, including rural areas in most cases. Sample sizes are limited to around 1 000 persons in most countries (exceptions include Iceland and Luxembourg [c. 500]; Japan and New Zealand [c. 750]). Data for Germany and Japan are the average of four quarterly samples. Observed data points on each trend line are 'filled', estimates are 'empty'. Panel A records the proportion of respondents reporting being dissatisfied with the level of good quality affordable housing in the city or area where they live'. Panel B records the proportion of respondents who answered 'Yes' to the question 'Have there been times in the past twelve months when you did not have enough money to provide adequate shelter or housing for you or your family?'.

Source: Gallup World Poll, 2014.

5.18 An example of how SII can meet demand for affordable housing comes from the United Kingdom’s Tesco Supermarket chain which recently responded to debates on housing needs (as well as changing demand form their customer base) by unlocking it’s land banks for housing projects (reportedly including their own GBP 1 billion house-building project [see Guardian, 2014]). Contributions to housing stock, particularly when unlocking banked land, should contribute to macro-social goals for increasing available, and in turn affordable, housing stock (for a detailed discussion of the range and definitions of what constitutes a social impact investment see Chapter 4).

5.2.1.4 Policing, safety and crime

5.19 Crime is a blight on societies, and depending on the severity of the crime experienced, can have severe personal and social impacts. Reducing crime and the fear of crime are major social goals, and whether present systems are coping with expectations or not will provide an insight as to whether SII has a role in this sector.

5.20 Crime statistics are difficult to interpret accurately because they often rely on crimes being reported, and convicted, and this may result in important variations in different countries (and in turn national-level reporting biases). For this reason nationally-relative measures of contact with the police are report in Table 5.2, and show that although numbers are rising overall, and in France and Italy (but not for Italian juveniles), most countries report lower rates of people being in formal contact with the police since the mid-2000s.

5.21 Whether increases in contact with the police are a proxy for improvement in policing, and an improvement in overall safety is generally open to debate (lower rates might equally be due to higher risks and lower policing standards), and so indicators of safety and policing are also reported in Table 5.2. Results for confidence in policing and feeling safe in your locality would suggest that increased contact with police in France does not proxy a worsening social situation. In fact, across all countries, both confidence in the police and feeling safe in the locality at night have improved (with the exception of small falls in the latter indicator in Italy and Japan). For SII, although social outcomes seem to be improving in this sector, innovation may still be required, because progress is slow in many countries, and on average 3 in 10 people still report feeling unsafe outside at night or not having trust in the police.

Table 5.2: Indicators of Policing safety and crime trending in the right directions, but still have some way to go

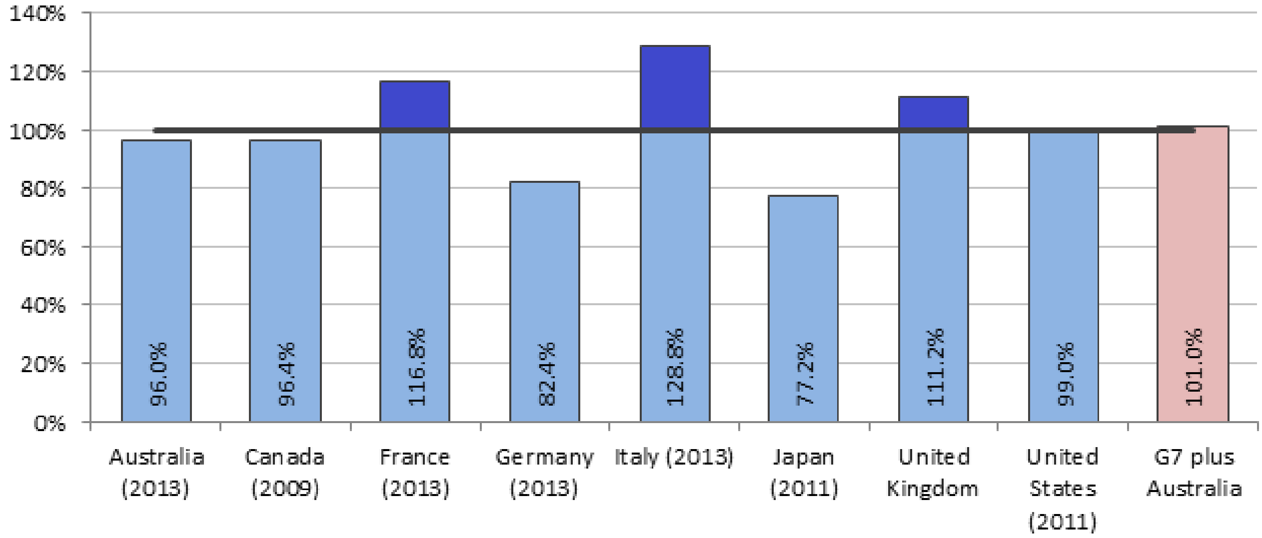
	Confidence in local police between 2007 and 2012		Do you feel safe walking alone at night in the city or area where you live?		Persons brought into formal contact with the police and/or criminal justice system, all crimes (Index 2004=100)		Prison rates of over 18s per 100,000	Prison occupancy rates
	2007	**2012**	**All**	**Juveniles**	**2007**	**2012**	**2011**	**c.2013**
Australia	78	80	...	...	77.2	84.3	167.1	96.0%
Canada	88	87	97	89	77.5	82.6		96.4%
France	73	74	112	134	66.6	78.2	131.4	116.8%
Germany	76	82	...	...	64	76.1		82.4%
Italy	74	76	118	93	75.3	74.8	132.5	128.8%
Japan	70	74	83	67	72.5	72.3	65.8	77.2%
United Kingdom	69	76	...	...	63.1	68		111.2%
United States	78	78	89	73	57.9	67.9	939.5	99.0%
OECD	70	72	106	105	68.3	72.2	193.8	...

Note: For crime rate changes OECD average is an average of data for 23 countries. For prison rates ("Prisons, Penal Institutions or Correctional Institutions" means all public and privately financed institutions where persons are deprived of their liberty. The institutions may include, but are not limited to, penal, correctional, and psychiatric facilities under the prison administration. "Persons Held" should exclude non-criminal prisoners held for administrative purposes, including persons held pending investigation into their immigration status and foreign citizens without a legal right to stay held prior to removal) Canadian data is for 2010. Prison occupancy rates United Kingdom data is for England and Wales only, data for Australia, England & Wales, France, Germany, and Italy are from 2013; 2012 in Japan and the United States, and 2009 in Canada.

Source: Society at a Glance (OECD, 2014b); citation of sources: Gallup world Poll, 2014 and United Nations Office on Drugs and Crimes (UNDOC - www.unodc.org/). For prison occupancy rates author's calculations of national informant data (available on request).

5.22 Finally, prison rates and prison occupancy rates are interesting indicators of social outcomes for the SII discussion because recidivism was the first social outcome to be linked to a social impact bond (recidivism data is not available due to problems with comparability across countries – see Richardson, 2009). The standout case in this picture is the United States, where prison rates are 5 times higher than the OECD average. Providing for prisoners is a costly process, and so innovation in crime / recidivism prevention services will be in general demand, which may create a space for SII products. Moreover, when prisons are over their capacity (above 100% occupancy rates – see Figure 5.4) this signals a pressing unmet demand for these services, or even alternative services to incarceration.

Figure 5.4: Prisons in France, Italy and the United Kingdom are overfull



Note: Prison occupancy rates United Kingdom data is for England and Wales only, data for Australia, England & Wales, France, Germany, and Italy are from 2013; 2012 in Japan and the United States, and 2009 in Canada.

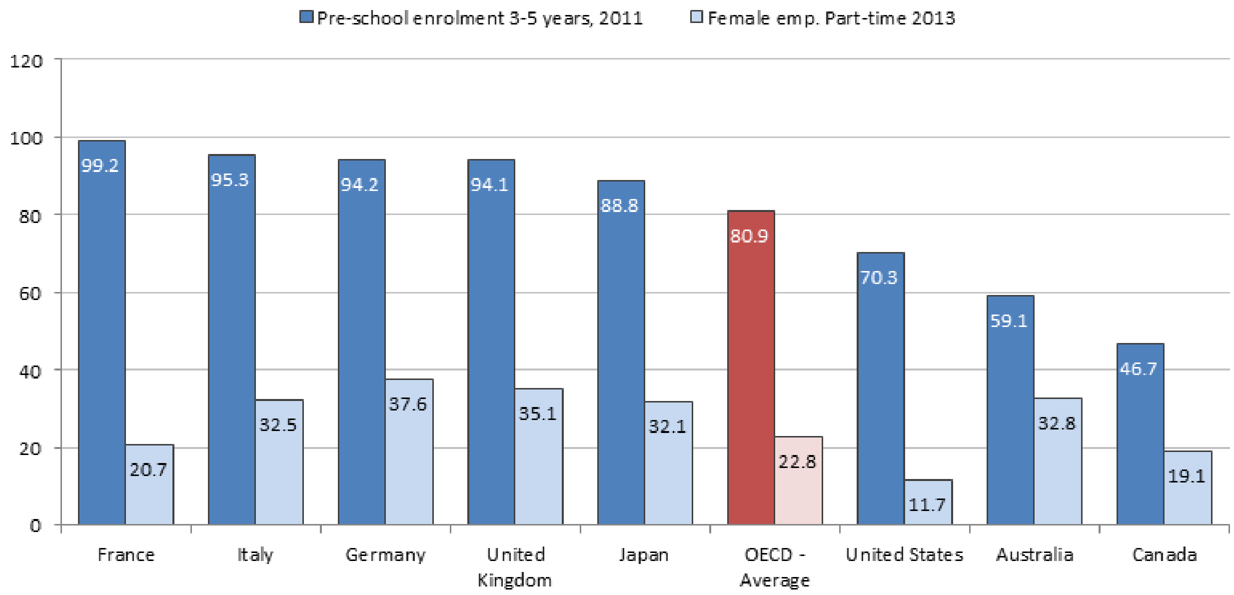
Source: Author's calculations of national informant data (available on request).

5.2.1.5 Family care and the employment of women

5.23 The social value of childcare for child development, family formation and female employment has been recognised for many years (OECD, 2011a), and has been supported by increases in public investment in this area in many OECD countries before the crisis (ibid) and one area of family policy that has seen expansions during the crisis period (OECD, 2014a). Childcare is also seen as an important contributor to the efficiency of social systems, preparing children for later schooling, increasing productivity in adulthood and reducing the likelihood of anti-social outcomes (see for instance Heckman and Masterov, 2007). Related to the provision of childcare, and important for achieving important gender equity goals for societies, is helping women access good quality secure employment.

5.24 Table 5.3 presents data on recent developments in childcare enrolment and prime-age female unemployment and part-time employment (Figure 5.5 maps female part-time employment to preschool enrolment). Together these data point towards changing demand for childcare services, as well as changes to childcare take-up, yet a general message is hard to interpret because the expected finding of an increase in childcare for both age groups is not reflected in positive changes to broad employment patterns for women of prime working age. Nonetheless, some country-specific findings can inform the SII discussion, including: a suggestion of a need for innovation in non-childcare support for unemployed Italian women, and an expansion in the provision of childcare in the United States, where there is likely to be unmet need in the pre-school years (3-5) in particular (see Figure 5.5).

Figure 5.5 In countries where there is low childcare enrolment and low part-time employment, there is likely to be unmet demand for childcare



Source: OECD dot.stat, education and employment series, the OECD Family database (both 2014e), and the Health Behaviour in School-aged Children Study (2010).

Table 5.3: Cross-nationally, changes in aggregate childcare enrolment do not map to female (un)employment figures

	Pre-school enrolment rate children aged 3-5 years		% children < 3 in formal childcare and pre-school		Women - Part-time employment		Women – Unemp. rate		Children 11-15 in foster or child homes (per thousand)
	2007	**2011**	**2006**	**2010**	**2009**	**2013**	**2009**	**2013**	**2010**
Australia	54.9	59.1		33.2	33.9	32.8	4.6	4.7	
Canada		46.7			19.8	19.1	6.1	5.6	11.4
France	100	99.2	42.4	48	21.2	20.7	8.2	8.7	14.1
Germany	91.2	94.2	13.6	23.1	39.1	37.6	6.9	4.6	4.4
Italy	98.3	95.3	28.6	24.2	30.2	32.5	8.5	12.4	17.4
Japan	88.7	88.8	22.5	25.9	30.5	32.1	4.9	3.9	
United Kingdom	89.8	94.1	39.7	42	35.1	35.1	5.2	5.6	5.7
United States	59.1	70.3		43.2	13.6	11.7	7.2	6.3	3.5
OECD - Average	77.4	80.9	28.8	32.6	22.7	22.8	7	7.5	7.4

Source: OECD dot.stat, education and employment series, the OECD Family database (both 2014e), and the Health Behaviour in School-aged Children Study (2010).

5.25 Another ‘family’ social need of interest for SII is children in out-of-home care. Supporting these children has the potential for large social impacts in terms of providing secure, supportive, and long-term home environments that maximise the child’s development opportunities and also reducing costs associated to institutional care (public and private). Table 5.3 presents rates of "looked after" children per 1 000 children aged 11 to 15 and shows that Italy and France have almost twice as many children in foster or child homes than the OECD average. Examples of SIBs already at work in this area, in the case of adoption in the United Kingdom and support for "looked after" children in Australia, however it must be stressed that care for the most vulnerable children should prioritise quality of placement over quantity of placements, and be carefully monitored for children’s living standards following placement.

5.2.2 The evolving size of the public share: public social expenditure by sector

5.26 There are a number of important reasons to introduce the size and type of public expenditure on social interventions for the SII discussion. First, how much public bodies in different countries presently spend on social interventions can be considered an indication of the revealed willingness to invest in social impact measures. Second, comparing spending amounts by sector can be used as a proxy for assessing the size and priority of different social impact investment 'markets' (prior to factoring-in the ambitions of SII). Third, comparing social spending across countries alongside social need can be used to highlight cost efficiency issues in the public sector, leading to an indication of the extent of need for innovation and new approaches, such as SII.

5.27 A number of dichotomies are important for understanding how SII, in its different forms, might fit into public service management: large companies and SMEs, cash and service benefits, and national and local markets and governance. Across these dichotomies there are links; with larger companies more likely to be involved in cash investments or financial services (insurance, micro-finance) rather than services which are more often managed at the local government level and within the potential remit of small to medium sized enterprise.

5.2.2.1 Government spending: where the money goes

5.28 Figure 5.6 maps government expenditure in the areas of social protection, education, health housing and public order (each linked to a social outcome area measured above) and clearly shows that human and social services account for the majority of government expenditure across OECD countries. The different ways in which public sector services are financed will inevitably result in different challenges for reform. For instance, where public benefits are financed though social contribution payments, recipients are likely to expect predefined conditions of delivery to be met (rates of payments, services standards, or services providers themselves) years into the future. Compared to services financed through general taxation, the contribution conditions are more likely to challenges to innovation.

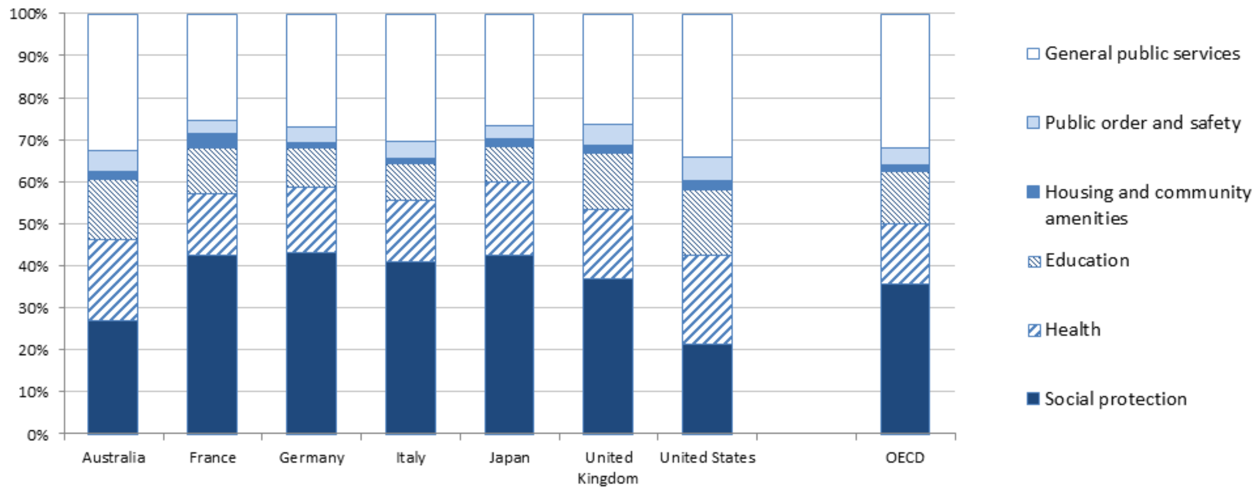
5.29 Social protection alone makes up one third of total government expenditure on average, and is over 40% of total government expenditure in France, Germany Italy and Japan. Social expenditure includes old-age care and pensions, as well as payment to families for childcare (family allowances and childcare, but not education), and unemployment and social assistance payments. Education and health also make up a large part of government spending, with around 1 in every 4 dollars going to these services across the OECD. In countries where social protection spending is relatively low, like Australia and the United States, education and health spending is higher. Over the three sectors of social protection, heath, and education each country spends around 60% to 70% of its budget.

5.30 Small but socially-relevant interventions of 'housing and community amenities' and 'public order and safety' top up the expenditure on social interventions by around 5-8% of total. France stands out as a country with relatively high housing expenditure, whereas the Anglophone countries are spending more of total on public order and safety.

5.31 Other research has mapped the trends in government expenditure, and shows that across the OECD as a whole, the biggest falls over the last decade came in the areas of general public services and to a lesser extent defence. Health, social protection, and economic affairs show the biggest relative increases (OECD, 2011b).

Figure 5.6: Social protection, health, housing and education account for over 60% of total public spending

Structure of general government expenditures by function (2011)



Note: 'General public services' includes general services, and spending on defence, economic affairs, environmental protection, and recreation, culture and religion. Canada is missing due to incomplete expenditure data. OECD average is for 30 countries (Chile, Mexico and New Zealand also missing).

Source: Government at a Glance, 2013e analysis of *OECD National Accounts Statistics* (database). Data for Australia are based on *Government Finance Statistics* provided by the Australian Bureau of Statistics.

5.32 An idea of the 'openness' of public services by sector to third party interventions can be gleaned from available estimates of the extent to which the public sector is co-producing[20] in these sectors. An OECD survey of 26 countries in 2011 (OECD 2011b – Brazil, Egypt, Russia and the Ukraine plus 22 OECD countries) mapped 'significant' civil society involvement in the delivery of public series and showed that of 58 examples of co-production, 19% were in social protection, 16% were in housing and community amenities, and 10% were in each of the areas of environmental affairs, economic services, education and health. In each sector, co-production in service delivery was found at all levels of governance (local, state and federal or national levels - ibid: 23).

5.2.2.2 Trends in social protection spending in cash and in-kind

5.33 The following section explores the evolving market space for SII by breaking down available government expenditure trends in total social protection, housing and health spending in terms of service provision and cash spending. The purpose here is to get a better idea of changing demand for social services, as it is in this area that SII might be possible for entrepreneurs from small, medium and large enterprises alike.[21]

5.34 Figure 5.7 maps the trends in cash spending and service expenditures in each of the G7 countries and Australia between 1996 and 2011. Across all OECD countries, on average, cash spending was falling

20 . The OECD report defines co-producing as "a way of planning, designing, delivering and evaluating public services which draw on direct input from citizens, service users and civil society organisations" (OECD, 2011b). This definition differentiates between voluntary involvement citizens and services users and civil society organisations (including via contractual and semi-contractual obligations) and formal contracting or outsourcing, services to the private sector (which are not included here).

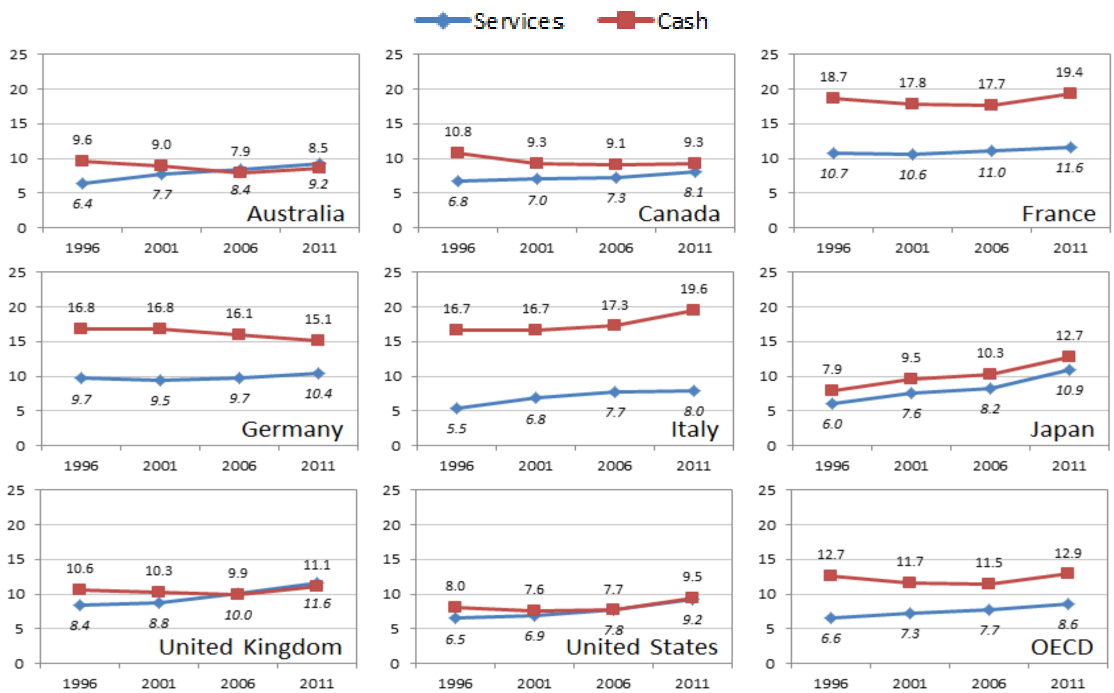
21 . Although there may be a role for SII in the provision of cash transfers (pensions, social insurance [maternity pay or hospital costs for childbirth] or micro-credit) these are high-risk large-scale areas more suitable for larger social enterprises.

pre-crisis only to pick-up again with increasing demand for low-income cash benefits following 2009. In contrast, service spending has been steadily increasing.

5.35 Not all countries follow the OECD trend however. Australia, Canada and Germany (the latter being a traditionally high cash spender) have all seen rates of cash spending fall over the period, whereas Italy and Japan have seen marked increases in cash spending. In regards to services, all countries with the exception of France and Germany have seen increases in expenditure of at least 1-2% of GDP or more. Service spending has increased by close to one-third in Australia and the United States, and almost doubled in total in Japan.

5.36 Although there is not much difference in service expenditure across the countries, three broad expenditure groupings are clearly shown here. The European countries of France, Germany and Italy are high spending countries, favouring cash expenditures. The Anglophones are lower-spenders but are more balanced by type, to the point where in Australia, the United Kingdom and the United States, expenditure levels are now favouring services. Finally, Japan is reporting stable upward trends across both spending types.

Figure 5.7 Expenditure trends show services are taking up more of the social protection budget, in some case exceeding cash spending



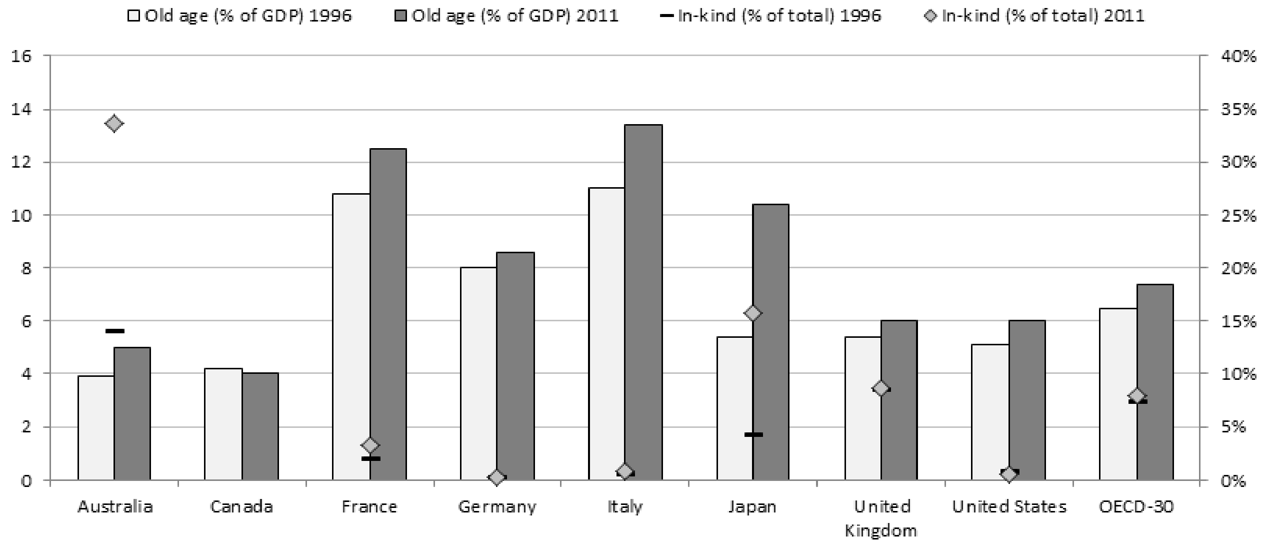
Note: Data report aggregate public social protection spending by type and do not include private social expenditure or education expenditure (public or private), but do include housing and health spending. Data for 2011 are provisional. Service spending reflects running costs of public services, cash spending reflects the value of cash transfers without administrative costs. OECD average is for 34 countries.

Source: OECD Social Expenditure Database, 2014a.

5.37 A limitation with Figure 5.7 is that it does not break down the social expenditure by sector, which is an important task for the SII discussion because of the different sector-specific challenges to this type of social entrepreneurship. For instance, one driver of the shift to greater service delivery overall is likely to be demographic change. In the area of social protection there are generally high rates of service intervention for the preschool years and end of life care, compared to higher rates of cash intervention across childhood as a whole, and into employment and living supports in adulthood (tax credits, minimum income guarantees and so on).

5.38 Figure 5.8 and Table 5.4 below introduce the breakdowns of spending types by sector, as well as trends of these breakdowns, for the G7 and Australia (covering old-age spending, health, housing, family and (un)employment). Results clearly show that increases OECD-wide in old-age, health, and family, and no consistent reductions elsewhere across all countries (a small drop in overall unemployment spending). In old-age, all countries with the exception of the Germany and the United States have seen both increases in overall spending and service spending, although in some cases this is small. The change in old age spending is likely to reflect the increasing need for elderly long-term care (personal and household services) as populations' age.

Figure 5.8: In most countries old-age spending is growing, in Australia and Japan, services are increasingly used



Notes and Source: Left-hand axis is for % of GDP, right-hand axis is for in-kind spending as a percentage of total spending. See table 5.4.

5.39 The OECD's social expenditure database also maps private (or non-government) social expenditures – where finances are managed by private bodies (Adema et al, 2011) – and shows that aggregate mandatory private and voluntary private spending by sector are highest for old age and health. Mandatory private spending refers to 'social support stipulated by legislation but operated through the private sector, e.g., direct sickness payments by employers to their absent employees…' whereas voluntary private spending refers to monies managed through 'privately operated programmes that involve the redistribution of resources across households' via collective support arrangements (see Adema et al, 2011c, 93:94 for more details).

Table 5.4: Old-age and Health spending dominate public social protection budgets, and have been increasing in almost all countries

		Australia	Canada	France	Germany	Italy	Japan	United Kingdom	United States	OECD-30
Old age	1996	3.9	4.2	10.8	8.0	11.0	5.4	5.4	5.1	6.5
		14.1%	*n.d.*	*2.0%*	*0.2%*	*0.6%*	*4.2%*	*8.5%*	*0.8%*	*7.3%*
	2011	5.0	4.0	12.5	8.6	13.4	10.4	6.0	6.0	7.4
		33.6%	*n.d.*	*3.3%*	*0.2%*	*0.9%*	*15.7%*	*8.7%*	*0.5%*	*7.9%*
Health	1996	4.6	5.8	8.0	7.8	5.1	5.3	5.3	5.8	4.9
		…	…	…	…	…	…	…	…	…
	2011	5.8	7.2	8.6	8.0	7.0	8.2	7.7	8.0	6.2
		…	…	…	…	…	…	…	…	…
Family	1996	2.8	0.8	2.7	2.0	0.7	0.5	2.3	0.5	1.8
		21.2%	*13.8%*	*42.1%*	*37.8%*	*35.3%*	*62.4%*	*20.8%*	*52.9%*	*27.8%*
	2011	2.8	1.2	2.9	2.2	1.5	1.4	4.0	0.7	2.2
		31.3%	*17.9%*	*57.7%*	*44.6%*	*50.2%*	*34.8%*	*34.6%*	*87.3%*	*43.1%*
(Un)employment	1996	1.7	1.6	2.9	2.9	1.0	0.8	1.1	0.5	1.9
		31.3%	*28.4%*	*41.9%*	*44.1%*	*34.9%*	*38.8%*	*34.8%*	*32.3%*	*32.2%*
	2011	0.8	0.9	2.5	2.0	1.2	0.6	0.8	0.9	1.6
		35.9%	*25.6%*	*37.2%*	*40.1%*	*33.9%*	*47.2%*	*51%*	*13.8%*	*35.8%*
Housing	1996	0.2	0.6	0.9	0.3	0.0	0.0	1.7	n.d.	0.4
		…	…	…	…	…	…	…	n.d.	…
	2011	0.3	0.3	0.8	0.6	0.0	0.1	1.5	n.d.	0.4
		…	…	…	…	…	…	…	n.d.	…

Note: Cells in white report the total public spending by year on each sector as a proportion of GDP, shaded cells report the proportion of this spending delivered in services with the exception of (un)employment where shaded cells represent the proportion of total spending on active labour market policies. "n.d." is for no data, and "…" replaces 100% for health and housing services where total spending matches total service spending. 2011 data is provisional.

Source: Author's calculations of OECD Social Expenditure data, 2014a.

5.40 Perhaps surprisingly, voluntary private spending outstrips mandatory spending in all countries (with the exception of Italy – total voluntary spending is almost 4 times as high at 2.3% of GDP on average in 2011) and Old Age interventions (via pension contributions, at 1.3% of GDP on average) generally receive more voluntary private investment than health (with the exception of France, Germany and the United States via health insurance and pharmaceutical purchases). Notably for social enterprises, particularly in what might be small to medium sized enterprises, service interventions play a very small role in private social expenditure.

5.41 Across the OECD as a whole, total education expenditures from public and private sources are also rising (as well as in all of the G7 countries and Australia, with the exception of France and Germany – see online data annex, and Education at a Glance [OECD, 2013c]). On average in 2010, total public education spending in the OECD countries stood at 6.3% of GDP compared to 5.4% of GDP in 1995. It is important to note however, for interpreting where space may exist for SII, these education figures do not disentangle private spending – whether promoted through mandatory systems, paid by families, or paid by local voluntary or professional services – from public spending. In most countries private spending is small relative to public and will more likely go to fees and variable costs associated with education provision (educational items, books and so on), and not fixed capital costs (buildings and their up-keep and wages) that public funds cover. SII may look very different in education space depending on which type of education service is being provided, and which market will provide the custom (private or public). Further breakdowns might be made in future research, and some countries will be more affected by this than others, including Japan where private education spending is higher-than-average.

5.2.2.3 Limitations of the data and appropriate interpretation of the data by sector

5.42 Social expenditure figures are taken from the OECD Social Expenditure Database (SOCX), education spending figures are taken from OECD Education Database. In theory all government expenditure should be in the Social Expenditure Database; however it is easier to collect federal spending than regional or local spending because state governments or devolved authorities do not always report to national governments how the money they managed is being spent (that which is raised, or devolved through block grants or other mechanisms). In practise this may mean social expenditure data may not fully represent all spending in countries where money is managed independently at local or regional levels.

5.43 Correct interpretation of the spending figures is important for accurate estimation of the need, and the potential boundaries, for SII – and so some caution is required. In some cases, missing spending is more likely to be found in some benefit types and sectors rather than others. For instance the Swiss and U.S federal systems allow for parental and maternity leave benefits to be provided by cantons or states, and as such are examples of where family spending can be missed, and cash-based interventions under stated. Yet, issues to do with missing expenditure are not restricted to federal countries or cash benefits. In the Netherlands for example, block grant expenditure from central to local government can hide additional spending on children as municipalities provide the childcare support, and they may finance this service out of the general block-grant made to municipalities.

5.44 Finally, social expenditure figures do not cover administrative costs (particularly in cash) or spread the value of large one-off costs (buildings for instance), which in both cases mean that annual estimates represent an underestimation of the total public cash or service intervention.

5.3 Models of Social Service Provision: Who does what and how?

5.45 Having looked at the broadly at the potential market space for SII, this section looks in more detail at how governments are presently meeting the demand for social services.

5.3.1 Practices in public social service delivery

5.46 In practice, the process of public social service delivery is not too different from providing services in the private sector. Simply put, the delivery cycle of a social service includes a planning stage, delivery process and review. In more detail: planning covers when service decisions are made (the 'gap in the market' or 'social need' is indicated), and the services are planned and designed; the delivery process involves commissioning services or service delivery by public employees; and, the review process involves service evaluation and service re-design (OECD, 2011b).

5.47 In the majority of cases the process of delivery is a cycle; unless a new need is identified or system innovation is undertaken (this can be driven by effectiveness or efficiency reasons). Recently, two factors have driven the need for innovation in social services delivery, the first being increased demand for multiple services in the most vulnerable populations, and the second being reductions in available resources driven following the onset of the financial crisis and global recession (OECD, 2014f).

5.48 Innovation in social services, increases in demand, and pressures to lower public budgets all point towards a potential role for new models in delivering social services, including a potential role for social enterprises. However, the nature of public service delivery can create specific challenges to social enterprise involvement, and so are salient to the SII discussion, such as:

- **Governance:** whether services are managed and financed at the central, regional or local level, or even a combination can mean many actors, with different political and financial pressures, influencing the service delivery methods and desired social impacts. Complex forms of governance can create different challenges for private social service delivery organisations joining the social market space particularly in the case of integrated social services, discussed below.

- **System planning:** Public interventions are designed to fit into systems, meaning complementary public services are considered in the design. SII will exist in a system of complementary public services which may be relied upon to regulate demand for an SII service, or facilitate outflow from a service (e.g. social protection will limit/regulate the inflow of homeless people into an SII homeless service, and homeless treated with SII may benefit from public employment services on exit). These complementary services will inevitably impact on the achievability of social impact goals set for an SII, and may create sustainability risks.

- **'Cross-sectoral' returns and 'wrong' pockets**: Related to system planning are the possibilities for cross-sector returns, which for SII may mean returns ending up in the 'wrong pockets' (see OECD, 2014f). Where public finances control multiple sectors, systems planning can allow for returns to accrue in *sector A* from interventions undertaken in *sector B*. Moreover, not all returns will need to be tracked or monetised, in the public system, or achieved within a pre-determined timeframe – in each case an important challenge for SII reporting.

- **Fixed capital and human capital:** At present, in many countries, public service systems have large banks of fixed capital and many employees. These bring hidden costs to social service spending (rates in Figure 5.5 report running costs), but can also represent additional policy options (with social outcomes) for governments if the location of the service and the employment conditions therein are part of national plans for employment creation, retention and safe employment. Both costs and purposes can result in a small market space and lower liquidity of public funds for private social delivery organisations.

- **Borrowing, funding streams, and sustainability:** Public services are backed by nations and traditionally have had access to borrowing or funding streams to allow for the treatment of social need even in the most difficult economic circumstances. They do not have a profit principle, meaning they can trade-off low cost cases with cases business might see as too costly to work with. Critiques of SII highlight the profit-principle which may 'trump' social efforts at the individual or community level if the business model becomes unsustainable (Yunus cited in Esposito, 2013).

5.49 Meeting these challenges effectively is essential for the general SII business case, as well as for the SII business case by sector (where these issues can be more or less important). The following sections address both the governance issues and issues with gaps in public service, data, evaluations and measuring social impact. For the other points there is no further discussion, but this should not detract from their importance, or the need for effective solutions.

5.3.2 The governance of public benefits and budgets

5.50 Table 5.5 records the level of governance involved in the delivery of services in the sectors of social protection, employment services, housing, health, education, and public order. Where data is available, each country row records the level of governance at which social services are managed by sector.

5.51 At first glance this table highlights the complexity of social service delivery across the G7 countries and Australia, with all countries involving different government levels across the sectors, sometimes mixing government stakeholders within sectors, and involving multiple stakeholders in a single service area in just over one-third of cases (40 out of 112 examples, sometimes including private providers). Australia, France, Japan and the United Kingdom have the most centrally-managed services, Australia and Canada have many regionally-managed services (state or provincial level), and local government is involved in 7 settings out of 12 in Germany. The United States has by far the most tiered settings, with no area involving fewer than two government partners.

Table 5.5 The governance of social services is complex and varied across countries

	Social protection		Employment		Housing		Health			Education			Public order	
	Social Assistance	Family cash benefits	Job centres (& Job training)	Cash benefits	Institutions (homeless, children in care)	Social Housing	Secondary health services	Primary health services	Mental health / counselling services	Compulsory	Childcare	Adult Education (lifelong learning)	Policing	Prisons
Australia	C/F	C/F	C/F	C/F	*CF, R*	*CF, R*	R	R	R	R	R	R	*CF, R*	R
Canada	R	*CF, R*	C/F (from 2017)	C/F	...	R	R	R	R	R	R	R	*CF, R, L*	C/F
France	*R, L*	*CF, R*	L	*C/F, L*	R	C/F	R*	R*	R**	C/F	*R, L*	C/F	*C/F, L*	C/F
Germany	R	C/F	L	*CF, R*	L	*R, L*	*R, L*	*Pr. with R, L*	*R, L*	R	L	R	C/F	R
Italy	*R, L*	C/F	R	C/F	...	L	R	R	R	*R, L*	*R, L*	...	*C/F, L*	C/F
Japan	L	L	...	C/F	...	...	*C/F, L*	*C/F, L*	C/F	L	L	C/F	*C/F, L*	C/F
United Kingdom	C/F	C/F	C/F	C/F	L	L	*CF, R*	*CF, R*	*CF, R*	*C/F, L*	*C/F, L*	...	R	***C/F (Pr).***
United States	*CF, R, L*	*CF, R*	*CF, R*	*CF, R*	*CF, R, L*	*CF, R, L*	***Pr. with CF, R****	***Pr. with CF, R****	***Pr. with CF, R****	*CF, R, L*	*CF, R, L*	*C/F, L*	*R, L*	***CF, R (Pr.)***

Note: C/F is central or federal, R is regional (referring to states, provinces or counties), L is local (municipalities, local governments, city governments), Pr. denotes private provider involvement. Data is provisional.

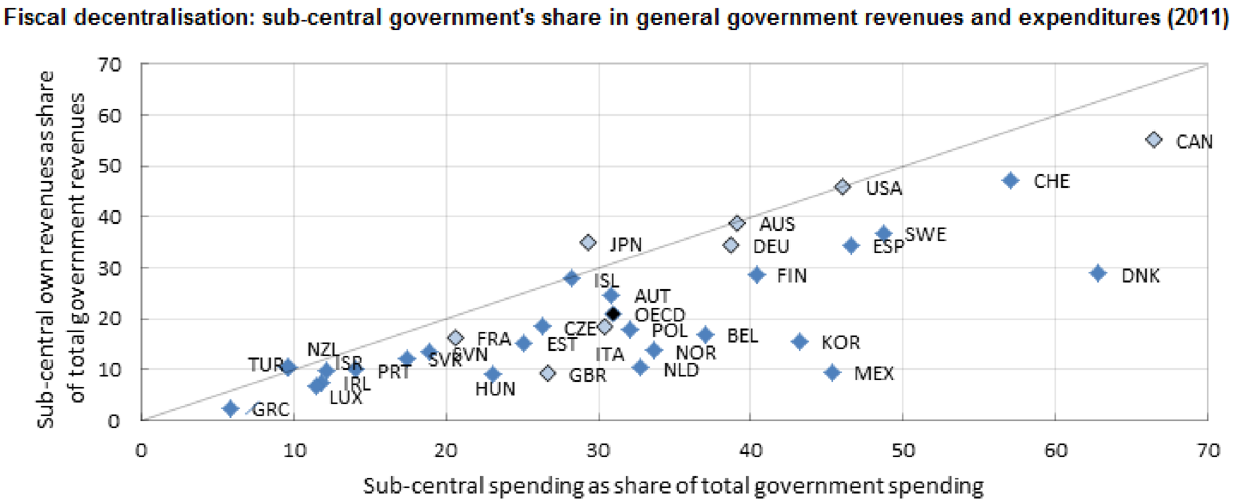
Source: OECD, correspondence with national-expert reviewers.

5.52 A number of issues for the SII discussion can be derived from the above. First, SII by sector will involve different business models by country, designed to 'fit' into pre-existing public models, and so transferability of good SII practice will therefore need to be assessed accordingly. Second, the complexity of systems and number of stakeholders in public settings is likely to limit the size of social enterprise start-ups generally, as the potential of co-production to scale will be limited or otherwise transaction costs may be high. Third, where sector investment and sector impact are not aligned in terms of management (primary health services improving school attendance in the United Kingdom for instance) additional challenges to measuring assessing the value an impact, and delivering reimbursements, will be additionally complex creating further transaction costs. Fourth, private enterprise is already a notable co-producer in the United Kingdom and the United States (cases are highlighted in bold in Table 5.5), the examples of which can inform practices in other countries. Finally, in some cases, the management and the resources by sector will not be aligned, for instance when central government block grants pay for local level service delivery (including outsourcing), which can create uncertainty and risk in regards to sustainability of SII funding sources, complementary public services, and the expectations for the social impact made by any given SII.

5.53 Evidence on how public resources are shared between levels of governance is shown in Figure 5.9. Using the example of Canada, on the top right-hand side of the figure, shows that sub-centrally derived revenues (y-axis), at below 60%, are lower than the proportion of total government expenditure undertaken at the sub-central level (x-axis) at over 60%. This means that some central government funding is being devolved to the sub-central level for administration (around 10% of total). All countries under the 45 degree line receive devolved funds to some degree. Notably, in Australia and the United States sub-central governments only administer their own revenues; in Japan, some sub-central revenues are administered at the central level.

5.54 For SII, as noted above, not only will this shift of funds create levels of uncertainty about streams of revenue etc. to social enterprise where it exists, but the information on the share of revenue administered at different levels highlights the potential for SII to function differently in different countries (nationally administered services will have different 'business' plans compared to locally administered services, for example in the areas of fixed capital and employee 'banks', economies of scale, underlying legislation and reporting/auditing mechanisms).

Figure 5.9 How much of central government funds are devolved to local authorities for social interventions varies widely



Note: G7 countries and Australia are highlighted.

Source: OECD (2013b).

5.4 Evaluating what works in social service provision

5.55 The evidence on social outcomes and social spending shown sections 5.2 and 5.3 can be used to highlight challenges and opportunities for SII. However, together these only highlight the space into which SII might move, and they do not provide any clear messages as to how to implement processes that might 'fill these social outcome gaps'.

5.56 This section reviews briefly the mix of evidence on good practice in public service provision in the area of elderly care and childcare, highlighting potential opportunities for SII. What is most evident is that better data and evaluations are needed. Chapter 7 discusses briefly ways to address this gap, and provides a point of departure for meaningful outcome measurement for impact evaluation in this area.

5.4.1 Good practice in service provision

5.57 Reading the data on social outcomes above alongside the data on public interventions clearly shows continued and sometimes expanding social need in the context of increases of public spending in most social sectors. In particular, the areas of elderly care and childcare stand out as priorities. For SII to make a meaningful contribution to these areas it is important to have an understanding of what makes for good practice in these areas.

5.4.1.1 Services supporting long-term elderly care: what works?

5.58 Increasing demand for long-term care of the elderly in many OECD countries is putting increasing pressures on many public budgets through increasing health costs (and creating social care service and pension needs) and this is projected to almost double in most countries over the next 3 decades. For these reasons integrated care services for the frail elderly have received much attention from policymakers in recent years. Below are some examples of integrated care practices and their social outcomes evaluations (focussing on reduction in hospital care) for the frail elderly:[22]

- A longstanding integrated care service for the over 75's in Canada (the *Programme of Research to Integrate the Services for the Maintenance of Autonomy* or PRISMA) coordinates integrated care provision through a joint governing board, and in some cases, pooled funds. A Randomized Controlled Trial (RCT) evaluation of PRISMA found reduced functional decline of programme participants, more satisfaction with their care, and reduced likelihood to re-use emergency department services 10 days after discharge (Hebert et al., 2005).
- Two small integrated care pilot programmes, *Rovereto* and *Vittorio Veneto,* were undertaken in in two provinces in Italy in the 1990s and provided integrated community-based medical and social services to the elderly. Evaluations of both programmes showed reductions in acute hospital admissions, and positive health outcomes amongst programme participants (MacAdam, 2008).
- In Victoria, Australia, the *Hospital Risk Admission Programme* (HARP) pilot provided services to elderly people who regularly attended hospital emergency departments. Through engagement with the elderly person's carer, case management, multi-disciplinary teams, and outreach, the service achieved a reduction in emergency department admissions (of 20.8%), inpatient care (of 27.9%) and number of bed days for inpatient care (of 19.2%) (Bird et al., 2007).
- In England, in 2008, the *Integrated Care Pilots programme* (ICPs) involved number of organisations integrating the care of older people with long-term conditions (via case management or care planning) for the purpose of lowering the risk of hospital admission. The evaluation of these two-year pilots showed decreases in planned admissions, outpatient service use and process improvements (e.g. use of care plans, professional training – without associated measurable social outcomes), but no increase in patient satisfaction was recorded, and there was no reduction in emergency department admissions (RAND, 2012).

5.59 Services delivery practices that were successful at reducing high cost emergency services use and hospital care included involving the elderly person's carer (HARP), case management of individuals, service planning and single point of entry to multiple service providers (all examples with the exception of ICPs), multi-disciplinary teams (HARP and *Rovereto* / *Vittorio Veneto*), screenings or assessments (PRISMA, *Rovereto* / *Vittorio Veneto*), outreach (HARP), service coordination boards (PRISMA).

5.60 Integration practices are gathering momentum in OECD countries as political interest in cost effectiveness grows – meaning SII and private social delivery organisations can embrace these approaches, and find solutions to the specific challenges of working in complex governance settings.

22 . The following evidence is summarised from OECD 2014f, Chapter 3, section 3.5.

5.4.1.2 Services supporting families with young children: what works?

5.61 Services to support families represent a different type of 'investment' expenditure and clear links with later life outcomes (in some cases creating returns decades after an intervention). Relative to the 'treatment' of frailty in old-age, family supports are an investment designed to 'prevent' children from being unprepared for school, the economy and society. Moreover, there is evidence of unmet demand for childcare in different countries of the OECD, as well as evidence of increasing public commitment to family services in every country in relative terms (the exception is Japan, where overall family spending has tripled, and although absolute level of family service spending has increased, this is relatively lower than cash spending).

5.62 Service interventions for families and children in France, the United Kingdom and the United States that have been subject to RCTs, show that:[23]

- Nurse-family partnerships and home health visits providing pre- and post-natal care for low income mothers and their infants in their own homes in New York, Memphis, and Washington produced positive gains in intended child well-being (including educational outcomes) and parenting outcomes including parenting practices (Greenberg and Shroder, 2004).
- Integrated childcare interventions in the United States (North Carolina's Abecedarian programme and Michigan's Perry Preschool), although relatively small (109 and 123 participants, respectively) produced large, long-term gains in education and health. These results have persisted over several decades, and in the case of the Perry Preschool service, early childcare also produced benefits in adult income and employment (Schweinhart and Weikart, 1993; Schweinhart, 2003).
- Evaluations of general family supports had mixed outcomes, with positive outcomes from the French intervention in Créteil that actively engaged parents and school to remedy truancy and disciplinary issues, and the Carrera programme in the United States which offered integrated support services to teenagers to improve educational engagement. Among the other family support interventions aimed at providing services for parent and child well-being, there were few benefits. Practices here included: case management and integrated service delivery (U.S. Comprehensive Child Development Programme), home visits by "supportive listeners" or community groups (British Social Support and Family Health Programme), and case management to teen mothers (the Young Families Can, Phoenix, United States) (OECD, 2014f).

5.63 Mobile home health units, and delivery of services in the home were successful in producing the desired social outcomes due to benefit of home service that reduce service take-up barriers (affordability, motivation etc.) and the chance it provides to professionals to gauge the full extent of the family living conditions and needs (McKeown, 2000). Childcare practices were successful where multiple integrated services (e.g. education, nutrition, health) are provided in childcare settings for the most at-risk children and less successful where fewer at-risk families took up the service (see OECD, 2104f). Finally, for more general family service interventions, successful interventions included engaging with parents in the school (for truancy and discipline), and less successful interventions included comprehensive support (parent and child well-being), case working (teen pregnancy) and supportive listening (maternal and child health – see OECD, forthcoming 2014).

5.64 Some key messages for SII here include: the highest social returns are found in the most vulnerable groups, although these groups will often require more intensive services; returns on social interventions in childhood may take many decades to come to fruition; and, providing services in people's homes, and to family units, creates unique opportunities for tailoring care to specific needs.

23 . The following evidence is summarised from OECD 2014g, Chapter 3, section 3.4.

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6. SOCIAL IMPACT INVESTMENT MARKET DATA: INITIAL FINDINGS

This chapter summarizes the initial work on data collection, focusing on the G7 countries and Australia. It reviews the available data and current data collection processes and highlights some of the data challenges, including in terms of pulling together reliable and internationally comparable data. It also provides recommendations for moving forward.

6.1. Introduction

6.1 As seen in the development of other parts of capital markets (venture capital, angel investment, etc.) data on activity and performance can play an important role in helping to grow the market. Even at this early stage of development of the social impact investment market, a stronger evidence base would help in encouraging a global market to develop (HM Government, 2013c). Different players involved in the market, including policymakers, have been calling for more data on SII as well as a better and more accurate understanding of the size, scope, evolution and potential of the market.

6.2 The OECD has sought to gather information on SII data sources and data collection processes. The research process included reviewing the academic literature that focuses on SII-related data, industry reports that bring together information on the size and scope of SII in the different countries and information from other data sources. The OECD conducted further research to provide an overview of existing SII data sources and data collection approaches, pinpointing main data-related challenges.

6.3 As an integral part of this process, the OECD worked together with SII data experts and academics to identify major data gaps and challenges, as well as to discuss ideas for better data collection in the future. The OECD organised two SII Expert Meetings in the first half of 2014. The first meeting took place on the 21st March, 2014 at the OECD headquarters in Paris. The second meeting was held on the 18th June, 2014 at the U.K. Cabinet Office, London. The OECD thanks the UK Cabinet Office for hosting the meeting as well as all participants in both workshops for their input into the process. The list of participants in both workshops can be found in Annex A.

6.4 A number of data challenges are common to all the parts of the SII framework. First, data needs to be collected in a more comparable way across countries. Harmonised definitions of social enterprises, social impact investors and social impact investment transactions are needed to facilitate cross country data collection efforts. Second, with unclear definitional boundaries, deciding what exactly is being measured (target population) is a major challenge and limits the scope for any sampling exercise. Third, and also as a result of definitional challenges, measurement errors are common, either overstating or understating the target population. Finally, it is unclear how detailed the data breakdown should be. Higher levels of granularity are more informative, but require data collection efforts that are more resource intensive and involve further related challenges in terms of deciding what should or should not be included as SII. Overcoming such barriers can help unlocking data that is not yet accessible.

6.5 This section discusses different data types, reviews which data are currently available, what types of data collection processes are currently in place and what other data is needed.

6.2. Data types and data collection purposes

6.6 Before engaging in data collection it is important to clarify the goal of collecting the data. Policymakers might be interested in collecting data to monitor market developments, forecast future developments or evaluate policy interventions. Such data will necessarily need to include information on social needs and social outcomes. These objectives are different from those of other market participants that might want to collect data, for example, to inform investors of investment opportunities. In this case, relevant data will include current risk-return profiles, benchmarking, and forecasting potential market (and segment) growth, *inter alia*. Some players (mostly intermediaries) collect data as part of their business model, as it will be discussed later.

6.7 Different data types serve these different purposes. For example, while monitoring the market essentially requires data on SII transactions (deals and volumes), forecasting will need a good understanding of potential demand and supply. In doing so, we make a clear distinction between potential demand and supply on the one hand, and effective demand and supply and transactions (i.e. satisfied demand) on the other hand.

6.8 For example, looking at the demand-side for SII (a parallel can be drawn to the supply-side), potential demand for SII originates from unmet social needs (discussed in Chapter 5) and is translated into the SII market through delivery organisations that require funding to address such needs. Most currently available data on SII demand concerns potential demand (see Section 6.3). In other words, it measures a population of social delivery organisations that could potentially be SII investees. However, it is important to note that not all social delivery organisations will become investees. This will depend on their financing needs and funding preferences as discussed in Chapter 3. Legal structures are also important as they may inhibit some SII-type of funding (e.g. NPIs). Therefore, only a fraction of the social enterprise sector, for example, will be SII investees.

6.9 Second, it should be clear that identifying the potential demand for SII is different from measuring effective demand for SII. Some reports (e.g. NAB reports; Brown and Swersky, 2012) focus on identifying the scope for future SII demand, which contrasts for example with the information coming from surveys that aims at identifying financing needs within delivery organisations (see Section 6.3).

6.10 Third, satisfied demand is the effective demand that is matched by capital providers\investors (possibly through intermediaries) and results in SII transactions, including deals and flows.[24] The nature and sources of data that allow identifying the scope of potential and\or effective demand\supply, as well as transactions is likely to be different. For example, while transaction data will mainly come from intermediaries, estimating potential demand will require, *inter alia*, a combination of governmental data and detailed financial information on delivery organisations. Therefore, it is very important to decide *a priori* what type of data is needed to serve the purpose of a specific data collection effort.

6.3. Review of Existing Data Sources: Data sources by framework component

6.11 Overall, current data availability on SII is very limited. A comprehensive picture of the SII market requires sizing the different components as discussed in Chapter 3: i) SII demand (including social needs and social service providers); ii) SII supply (i.e. pools of capital and investors); iii) SII intermediaries and financing instruments.

6.12 Annex 6.1 provides a list of SII data sources for G7 countries and Australia. The UK is the country in which most data is available, as a result of 10 year track record of SII market building, as well

24 . Returns and other relevant data associated with SII flows is considered here to be part of transactions.

as a series of commissioned surveys and research papers. The list contains information gathered through desk research and further information received from participants in the Social Impact Investment Expert meetings. The data sources are organised in accordance to the SII framework. Three main data categories are identified and correspond to information on the demand (SII investees), supply (SI investors) and transactions (SII intermediaries). For each category, examples and some of the specific data challenges are described below.

6.3.1. Demand- side data

6.13 Demand-side data for SII includes information — both demographics and financial information — about a number of different market players that deliver social services or goods and are potential (or effective) investees. Table 6.1 below summarises the key demand-side players, data-related challenges as well as some examples of data sources. Demand side data can be obtained from different types of data sources.

Table 6.1. Summary of type of demand-side players, challenges and data sources

Organisation Type	Definition & Data Challenges	Types of Data Sources
Social entrepreneurs (SE) **Charities** **Non-profits institutions (NPIs)** **Social purpose organisations (SPOs)** **Cooperatives** **Development trusts** **Mutuals**	**No consensus on the type of organisation to be considered within the scope of SII** **Taxonomy is country-specific** *"Solidarity" companies, FRA* **Legal form of companies varies by country** **No match between legal form and the SI investee**	**Business Registers \ Statistical Offices (legal structure)** *Community interest Companies (CIC), UK* **Surveys** *SESS, CAN; ICSI2007, ITA* **Certification Organisations** *B-Corporation; IRIS; GIIRS* **Associations** *Cooperative Association, GER* **Directories** *Groupe SOS, FRA; Non-Profit Finance Fund, US;*

Notes: Some examples are provided in italic below each point.

Source: OECD, based on desk research.

6.14 Some SII demand-side organisations have a specific legal structure or a generally accepted classification (e.g. community interest companies in the U.K, "entreprise solidaire" in France). It is possible to collect SII demand data, based on aggregation of data from organisations with specific legal form(s). The underlying information can be obtained from National Statistical Offices (NSOs) or other agencies that compile business register data. However, social enterprises and other social providers are defined by their objective of providing social outcomes, thus organized in many different legal forms (GHK, 2013). By providing incentives for social enterprises to report information (e.g. certification, visibility and investor networks), some organisations have been able to collect information on SII demand (e.g. B-Corporation, GIIRS).

6.15 Legal structures and certification do not always allow a precise mapping of SII demand-side organisations, nor do they necessarily provide financial data (important to understand financing needs). Creating a common and well defined legal type category for social businesses can help in identifying social companies and sizing the market as well as targeting policy. While in some countries, legal mechanisms that recognise some form of SII-related business structures are already in place, further efforts to create the appropriate formal enterprise structures are needed (WGMA, 2014).

6.16 An alternative to drawing upon legal form is to conduct demand side surveys, specially designed to identify the scope for SII demand. Surveys are the most common form of obtaining SII data and are discussed at length later in the chapter. The Non-profit Finance Fund survey in the United States is an example of a demand-side survey specifically aimed at understanding the financing needs of social enterprises. This was also the approach followed by the provincial-level Social Enterprise Sector Surveys initiative (SESS) in Canada described below in Box 6.1. Close collaboration with local institutions and organisations was important to ensure a good coverage of the survey. The major drawback is that mapping SII using this approach can be extremely time consuming and resource intensive.

Box 6.1. Social Enterprise Sector Survey

Purpose

The Social Enterprise Sector Surveys (SESSs) are conducted within a project that aims at highlighting “the size, scope and impact of social enterprises at a provincial level”. Identifying the demand for SII is not the original purpose of these surveys. However, by mapping the social enterprise sector along with the financial performance of identified social enterprises, SESSs can provide an indication of the scope for SII in the surveyed Canadian provinces. The first surveys were launched in 2010 (British Columbia and Alberta) and by the end of 2014, most Canadian provinces will have been covered at least by one survey wave. A total of 15 SESSs have either been completed or are currently being carried out.

Definition of social enterprise and survey approach

In order to conduct the surveys, a social enterprise (SE) were defined as follows:

- In terms of function, the enterprise should “provide goods and services in the marketplace, motivated by a clear social, cultural, environmental or employment mission”.
- In terms of legal structure, the enterprise should i) be incorporated as a NPI or ii) be a private company 100% owned by a NPI.

This definition excludes a number of important organisations active in the SII market such as co-operatives, voluntary associations and, most importantly, social purpose business ventures and other forms of social business activity by the private sector. Therefore, this approach results in conservative estimates of the scope of the SE sector.

The objective is to survey the population of social enterprises in each Province, using the following steps:

- Identify potential social enterprises through a close collaboration with local institutions and organisations, knowledgeable about the potential scope of the SE sector in each province;
- Contact potential social enterprises to screen out those that would not be considered as SE according to the working definition;
- Send the questionnaire to identified SE

Sampling challenges remain, in particular since it is not fully clear what is the representativeness of the sample. In addition, of those organisations identified as social enterprises, the response rate has, so far, been around 30-40% and obtaining further information on non-respondents still remains a challenge. Nevertheless, the strength of this approach is to focus on the local level and engaging with local organisations and institutions involved in the social enterprise sector, which allows for a better understanding of the potential scope of the sector in each region.

Resulting indicators

Indicators developed include business demographics, sales and revenue, expenditures, employment and volunteer engagement. These provide a broad overview of the scope of the SE sector as well as key characteristics of social enterprises across the different Provinces. More importantly, they contain information on the financial performance of social enterprises.

In addition to objective information on financial performance from expenditures and sales (and other forms of revenues), the new wave of surveys launched in 2014 also includes a number of questions regarding social enterprises' access to finance. As an example, the 2014 SESS for Alberta explicitly asks whether access to loans, access to grants or cash-flow management were a significant challenge for social enterprises. Together with objective financial information, survey results can provide a baseline estimate for the scope for SII in each Province.

Source : Elson and Hall (2013); http://www.sess.ca/english/

6.17 In addition, some types of social ventures belong to various associations and networks. This is, for example, the case of the Cooperative Association in Germany. The existence of such associations can help with sampling. Moreover, associations of specific types of delivery organisations (e.g. cooperatives) may also collect data on members. It is often in the interest of associations to disclose some information about their members for promotion purposes. Some organisations involved in SII activity also maintain directories of delivery organisations. This is, for example, the case of some NPIs active in SII such as the Groupe SOS in France, or financial intermediaries that share a list of its portfolio companies (e.g. Oltreventure; ClearlySo).[25] These associations and networks can be a key interlocutor in future data collection efforts.

6.18 Analysing the demand side of the SII framework involves a number of challenges. First, it is not yet clear what type of organisation should be considered within the scope of SII. For example the discussions are still evolving in terms of what exactly can be considered a social enterprise. Literature shows that social enterprise definitions have changed across time and geographies (Kerlin, 2010), and is strongly influenced by differences in social context. As an example, in the analysis of the 2013 Alberta SESS above, Elson et al. (2013) note that the definition of social enterprises "excludes social purpose business ventures and other forms of socially responsible business activity by the private sector, as well as enterprising activities by all orders of government". Changing definitions over time result in challenges for data interpretation. Focusing on the social intent of organisations, as described in Section 4, could help in identifying the demand side of the SII framework. However, collecting data based on social intent would require an objective and consensual measurement of intent.

6.19 Teasdale et al (2013) show how different criteria to identify social enterprises in the UK, used in surveys over time, has resulted in biased estimates of the growth of the social enterprise sector (Figure 6.1). While for example initial surveys such as the ECOTEC, 2003 could understate the full extent of the social enterprise population (Type I error), the ASBS dataset compiled in 2007 might have included companies that are beyond the scope of the social enterprise concept (Type II error) — Type I and Type II errors are discussed at length in Section 6.4. Therefore, any interpretation of the increase from around 5 300 social enterprises in 2003 to around 60 000 in 2007 must take into account changing criteria over time.

6.20 Second, legal forms do not match what could be understood as an SII investee. Even if they did, these would not necessarily be comparable across countries. Due to the different systems, taxonomy varies from country to country. As an example, "solidarity" companies in France are not directly comparable to social cooperatives in Italy or community interest companies in the UK. In mapping the social enterprise sector across EU countries, Wilkinson et al. (2014) finds a wide range of legal forms and classifications in different countries.

25 . Oltreventure's directory can be found at http://www.oltreventure.com/index.php/investimenti/riepilogo. ClearlySo provides a directory of social enterprises around the world, available at http://www.clearlyso.com/directory.html.

Figure 6.1. Social enterprise in UK surveys

Survey undertaken	Data source	Sampling Frame	Interpretation of key elements: *a business*	Interpretation of key elements: *primarily social objectives*	Interpretation of key elements: *reinvestment of surplus*	Estimated social enterprise population
1999–2003	ECOTEC, 2003	Existing local surveys	50% of income derived from trading	Governance and ownership structure based on democratic participation	Surplus can only be distributed to stakeholders as profit sharing or used for the benefit of the community	'up to 5,300'
2004	IFF Research, 2005	Companies Limited by Guarantee and Industrial and Provident Societies	25% of income derived through trading	The primary purpose is to pursue a social goal (or) to make profit for owners, partners and shareholders?	Asked whether profit is mainly distributed between owners, partners and shareholders; (or) mainly reinvested in the organisation or community, to further social goals?	'around 15,000'
2005	ASBS dataset 2005	All enterprises with less than 250 employees	25% of income derived through trading	Asks if organisation is a close fit with the DTI definition	organisations which do not pay more than 50% of profit to owners/shareholders	55,000
2007	ASBS dataset 2007	All enterprises with less than 250 employees	25% of income derived through trading	Asks if organisation is a close fit with the DTI definition	organisations which do not pay more than 50% of profit to owners/shareholders	70,000 (62,000 figure based on rolling average)
2009/10	NSTSO dataset 2010	Third sector organisations	50% of income derived through trading	Asks if organisation is a close fit with the DTI definition	Asks whether (all) surpluses are used to further social and/or environmental aims	8,507

Note: DTI stands for Department for Trade and Industry. In 2002 DTI defined social enterprise as "a business with primarily social objectives, whose surpluses are principally reinvested for that purpose in the business or in the community, rather than being driven by the need to maximise profit for shareholders and owners" (DTI, 2002). ASBS stands for the Annual Small Business Surveys where questions were added by DTI in order to assess the percentage of social enterprises in mainstream businesses. NSTSO is the National Survey of Third Sector Organisations. Please also refer to ECOTEC (2003) and ITF (2005).

Source: Teasdale et al. (2013). © 2013 The Author(s). Published by Taylor & Francis is licensed under http://creativecommons.org/licenses/by/3.0/.

6.21 Third, most of the information available on the demand side provides general demographic information on organisations that may require SII funding, but information on actual financing needs is scarce. Social enterprises do not necessarily disclose the relevant financial information needed to understand whether pressing financing needs exist. Therefore, information available is usually limited to a sample of firms for which financial information is available (e.g. Unicredit Foundation, 2012) or based on surveys that specifically ask for financing needs. In order to derive effective SII demand, it is necessary to look at how much financing delivery organisations need. Further efforts to collect data on financing constraints of social enterprises or information that allows for the estimation of the underlying financing needs (e.g. detailed financial information on social enterprises) are still needed.

6.3.2. Supply-side data

6.22 While not much data is available on effective supply of SII financing, except that obtained from surveys, investor platforms and transaction data sources, different data sources exist that provide information on potential pools of capital that could be deployed — Section 6.2 discusses the distinction between data on potential and effective SII activity. Also, SII supply forecasting exercises are increasingly common, but require strong assumptions such as the percentage of assets that may be committed to SII. As mentioned before, sources of data that allow measuring effective supply are likely to be different from those used for potential supply and forecasting.

6.23 Some data sources provide information on social impact investors and, more broadly, organisations providing finance to social ventures. As discussed earlier, the supply of SII can include a wide variety of players from foundations and venture philanthropy funds to institutional investors and high net worth individuals (HNWI). Governments also play an important role. Traditionally, they have been the largest providers of funding to address social issues, either through cash transfers or direct provision of social goods or services (see Chapter 5).

6.24 Table 6.2 below summarises the key supply-side players, data-related challenges as well as some examples of data sources. Supply-side data can be obtained from different types of data sources. Data related to the role of the government as a social impact investor can be obtained from NSOs. However, different levels of administration (central; regional; local) can entail measurement challenges. In countries in which some tax breaks may apply, for example in the UK, National Tax Offices will store information about eligible companies.[26] Also, in the US, the IRS discloses a list of all organisations eligible to obtain tax-deductible charitable contributions.[27] Other institutions in the public sphere, such as central banks, financial market regulators and other financial supervisory bodies, monitor and compile information on investment activity and capital pools. The information is usually too aggregate, but can still be useful to estimate the potential capital that could be deployed into SII on the basis of a top-down approach due to difficulties in tracing-down actual SII amounts (Addis et al., 2013).

Table 6.2. Summary of type of supply-side players, challenges and data sources

Organisation Type	Definition & Data Challenges	Types of Data Sources
Government (National and local) **Foundations** **Social venture funds** **Venture philanthropy funds** **Institutional investors** **Corporations** **High Net Worth Individuals (HNWI)** **Mass retail (crowdfunding)** **Untapped pools of capital (dormant funds)**	**Most information is on potential assets to be deployed** **The actual amount of SII is hard to trace.** **Sizing and assessing potential entails significant assumptions.** **Confidentiality issues**	**National Statistical Offices** *Social expenditures, National Accounts* **Networks\Associations** *Japan Foundation Center; EVPA, Europe* **Surveys** *JP Morgan\GIIN;* **National Tax Offices** *Tax breaks* **Financial system** *Financial Market Authorities; Central Banks*

Notes: Some examples are provided in italic below each point.

Source: OECD, based on desk research

26 . Information on the UK's Social investment tax relief is available at https://www.gov.uk/government/publications/social-investment-tax-relief-factsheet/social-investment-tax-relief.

27 . Available at: http://apps.irs.gov/app/eos/forwardToPub78Download.do.

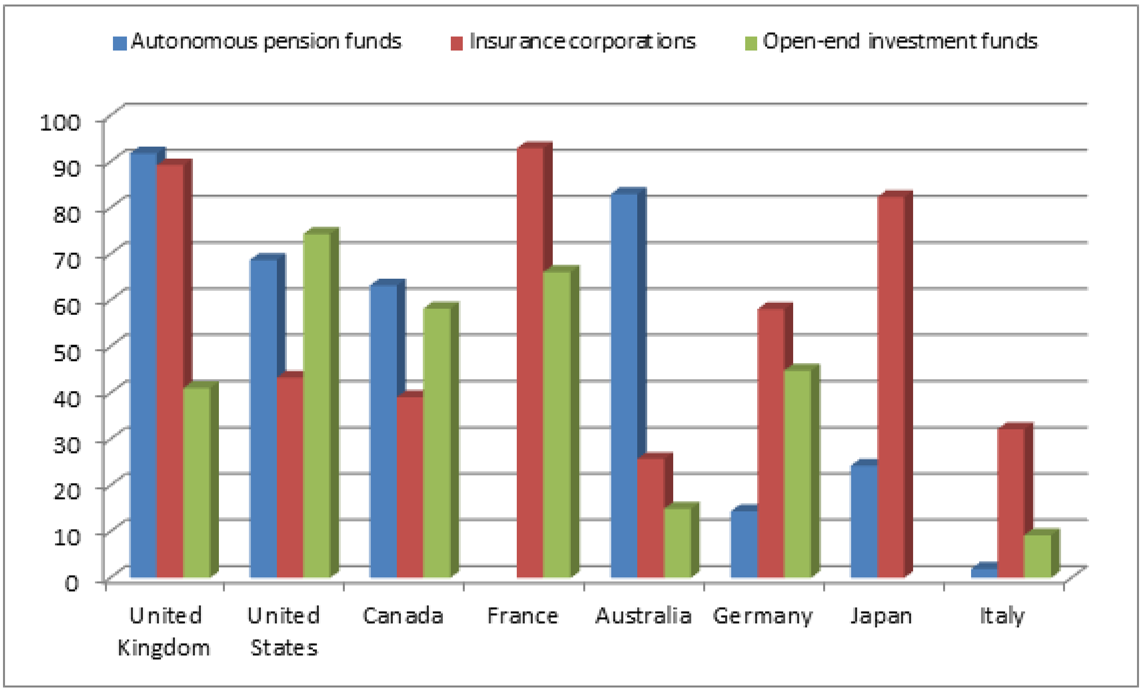
6.25 Associations and networks also track some data on investors. Examples of these include the Japan Foundation Centre for foundations; ACRI for bank foundations in Italy or EVPA for venture philanthropists across Europe. However, they typically only provide information on specific types of investors and coverage is limited to membership and to certain categories of data that fall short of what is needed for an effective mapping of SII.

6.26 Information about institutional investors sourced from the financial system (central banks and financial market authorities) as well as international organisations (e.g. OECD, IMF) and associations can also provide an indication of the size of assets that could potentially be deployed into SII, assuming a small percentage of those investors might be interested in SII. That interest would be conditional on a number of factors such as monetising social returns and the creation of adequate financial vehicles to attract investments from these investor types. A report by the World Economic Forum notes that these mainstream investors require at least a market risk adjusted financial return due to fiduciary responsibilities (WEF, 2013). The Asset Allocation Working Group report (WGAA, 2014) analyses how the fiduciary duty perception that SII cannot deliver required financial returns (amongst other challenges) has been limiting the allocation of funds to SII financial instruments. It also discusses how this challenge can be tackled and SII integrated into portfolio structures of mainstream investors in the future, increasing the opportunity for portfolio diversification.

6.27 Figure 6.2 below overviews financial assets held by major types of institutional investors for G7 and Australia. In comparison to GDP, these institutional investors hold large sums of money, even though investments may often take place overseas. In some cases representing more than 90% of GDP (e.g. pension funds in UK and insurance companies in France), institutional investors can steer the SII market even if committing extremely small shares of their total portfolios into SII.

Figure 6.2. Financial assets of institutional investors

As a percentage of GDP, 2011



Source: OECD (2013f).

6.28 As in other areas, surveys have been the main tool to profile social impact investors and quantify available capital. For example, in the JP Morgan\GIIN Impact Investor Survey series (Box 6.2 below) the survey sample has been increasing. This imposes some limits to a longitudinal analysis — in the last survey a subsample of respondents overlapping with the previous edition (67 out of 125) was used to make a comparative statics analysis. The most important is to guarantee that the sample provides a good idea about the effective distribution of characteristics across different investors.

6.29 The GIIN\JP Morgan survey is particularly interesting because it combines quantitative information (e.g. investments; assets under management; returns) with qualitative information (e.g. growth perspectives; return expectations). If efforts are made to obtain a representative sample with longitudinal data, it is possible to track if investors' expectations regarding the SII market are actually being met (e.g. Saltuk et al., 2014).

Box 6.2. GIIN\JP Morgan Survey

J.P. Morgan and the GIIN have been collecting data on impact investors through surveys since 2011. The joint surveys target investing organizations such as foundations, funds or financial institutions and apply a broad definition of impact investment, as described in Chapter 4. Individual investors are however excluded from the analysis. Also, only investors with assets under management above USD 10 million are included. As a consequence, the resulting sample is not representative of the whole SII market. Nevertheless, it is amongst the most comprehensive sets of information on the supply side of the SII market.

So far, three different survey waves have been carried out (2011, 2012 and 2013) and the sample of investors has been increasing (52, 99 and 125, respectively). Also, respondents do not necessarily overlap which means that caution is needed when interpreting trends along the different survey waves —The table below provides a comparison of targeted SII (amounts that investors are willing to invest) and the actual investment volumes in 2011, 2012 and 2013 survey waves. It is possible to see significant investment leaps between the survey waves. These cannot be regarded as market growth but rather sampling changes. Saltuk et al. (2014) make a comparative analysis that carefully focuses on the 67 survey respondents that had participated the year before (Saltuk, 2013). Tracking the exact same individuals would allow comparing *a priori* targeted investments for a given year with the subsequent volume of investments in that year.

2011 survey	**2012 survey**		**2013 survey**	
n=52;	n=88	n=87 (2013)	n=125	n=124 (2014)
Targeted 2012	Transactions (volume) 2012	Targeted 2013	Transactions (volume) 2013	Targeted 2014
3.8 investments	8,0 investments	9,1 investments	10.6 investments	12.7 investments

Note: in billion USD. Information on survey response rates is not available

The survey results convey information on a number of different investor characteristics, including investor size (AUM), investor type (e.g. family office, fund manager, foundations, etc…), headquarters and geographical focus, sector focus, asset class focus, investment stage focus, return expectations, sources of capital (for intermediaries).

In addition, information is also gathered with respect to investors' perspectives, in particular regarding: i) Adequate risk and return profiles; ii) Motivations for impact investments; iii) Evolution of the SII market (e.g. usage of standards, investment opportunities, availability of capital for SII); iv) Major challenges for impact investing; v) Role of policy; vi) Planned investments in the near future (1 year); vii) Importance of metrics to evaluate performance.

Source: Saltuk et al. (2011; 2013; 2014)

6.30 An important challenge in collecting supply-side data relates to confidentiality requirements. This is also an issue for data collection in the venture capital and angel investment markets, in which supply side data is collected by survey from investors. For example, while most information from financial system regulators is not disclosed, data originating from survey exercises often needs to be anonymised (e.g. if it requires the disclosure proprietary or other types of sensitive data). For example, confidentiality issues can be particularly relevant for high net-worth individual.

6.3.3. Intermediaries and transactions

6.31 In terms of sizing the SII market, obtaining transaction data is crucial. However, this type of data is very hard to access, perhaps due to the fact that the market is still in embryonic phase in most countries and the necessary data collection processes have not been put in place. Currently the data remains in small pockets, used only by those directly involved in the transactions.

6.32 Table 6.3 below summarises the key intermediaries, data-related challenges, as well as some examples of data sources. Data on intermediaries and transactions can be obtained from different types of data sources. Transaction data is collected by social banks and wholesale banks such as Big Society Capital in the UK. Social exchanges have recently been established in some G7 countries such as the UK (Social Stock Exchange) and Canada (SVX) although the earliest exchanges were developed in other countries. With increasing deal activity, these exchanges can become an important source of SII transaction data in the near future. Nevertheless, transactions through social stock exchanges will likely only account for a small share of total SII activity.

Table 6.3. Summary of types of intermediaries, challenges and data sources

Organisation Type	Definition & Data Challenges	Types of Data Sources
Social banks **Social investment wholesale banks** **Community Development Finance Institutions (CDFIs)** **Fund managers & Tax advantage funds** **Social exchanges** **Crowdfunding platforms** **SII Networks/platforms** DFIs and development banks	**Several organisations collecting data but different types and in various ways.** **Data usually collected to address investor needs.** **Market still in embryonic phase in most countries.** **Identifying the set of intermediaries can be helpful to identify all potential players collecting transaction data**	**Banks/Wholesale banks** *BSC, UK; Bpifrance, France* **Funds** *Impact Assets; NCIF, US;* **Social exchanges** *Social Stock Exchange, UK; SVX, CAN* **Investor platforms** *Impact Base, GIIN; Maximpact; Engaged Investment, UK* **Crowdfunding platforms** *Masssolution, US* **Networks\Associations** *Finansol, FRA; CFDA, UK*

Notes: Some examples are provided in italic below each point.

Source: OECD, based on desk research.

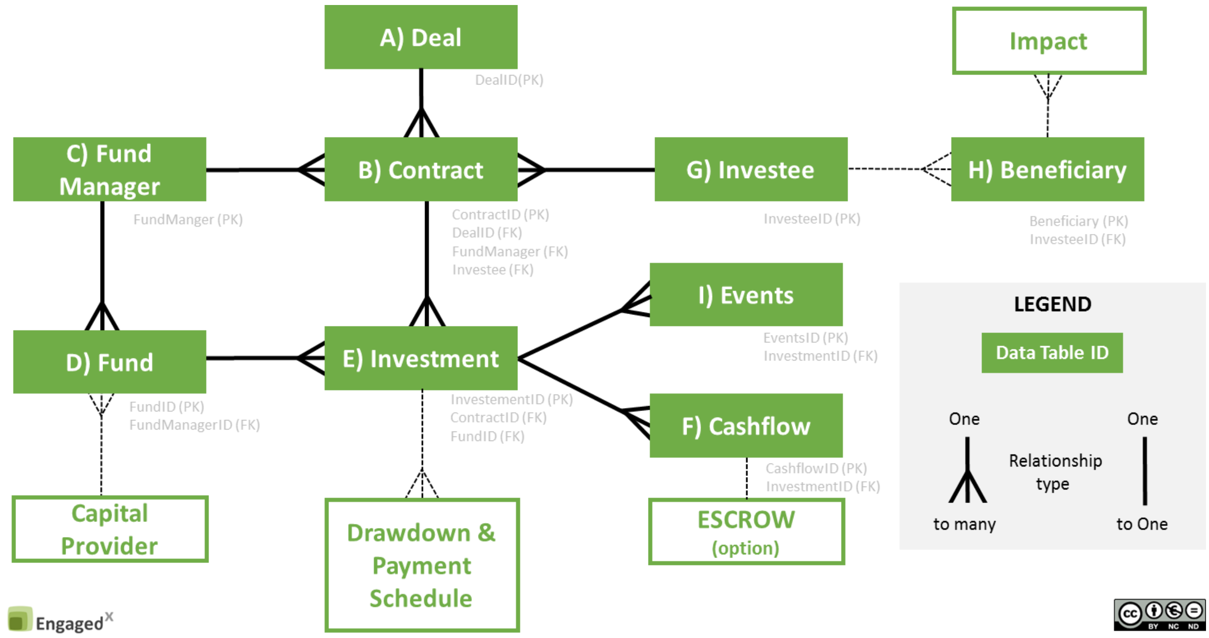
6.33 In parallel, the number of SII investor platforms has been increasing in recent years. These platforms provide a useful tool for investors interested in investing with a social impact. In addition, they gather information on investees, investors and, in some cases, transactions. Impact Base from GIIN or Maximpact (yet to become operational) are examples of platforms from which transaction data can be obtained. Some platforms, such as Engaged Investment in the UK, are not only collecting raw SII transaction data, but also developing taxonomy with the objective of constructing SII market indexes (see Box 6.3). In addition, there are specific types of platforms, such as Massolution in the US, that gather information on certain types of transactions (in this example, crowdfunding), some of which might be classified as SII.

6.34 Tax can play an important role in the SII market (City of London, 2013). Information on special tax regimes exists for example in the UK for social impact investment (Social investment tax relief). Tax offices would, in theory, be able to gather and aggregate such information, based on any tax credits and tax rebates that may apply. This approach could potentially provide a more comprehensive overview of both the number and volume of SII deals. However, accessing such administrative data is not always possible and requires overcoming confidentiality issues.

Box 6.3. Benchmarking SII: EngagedX

EngagedX collects SII transaction data with the objective of aggregating it into time-series market data that can be used to benchmark the performance of individual investments, funds or capital managers. Anonymised transaction data is being shared by leading SII intermediaries and fund managers in the UK, with plans to scale globally. EngagedX has been commissioned by the Social Investment Research Council (comprising Big Lottery Fund, Big Society Capital, the Cabinet Office, Citi and The City of London Corporation) to assemble a dataset of historic performance of the UK market. This dataset will bring together comparative data about outturn risk and returns of investments in relation to capital pricing.

Data is collected and normalised according to a reporting framework developed collaboratively by EngagedX and industry practitioners. This helps categorise and compare transactions according to a number of characteristics, including product type, risk banding, sectors, investor and investee characteristics as well as the nature of social outcomes. The figure below depicts the high level architecture of the EngagedX data model.



Source: EngagedX Investment STandards (EXIST), Version 2.2.2 (5 June 2014)

The resulting information will help showcase the risk-return profiles of SII in relation to mainstream capital markets. It will also identify the different drivers of social and financial performance in SII as well as how risk-return benchmarks vary across different social areas, geography or other relevant market segmentation.

Source : http://www.engagedinvestment.com, accessed on July 18, 2014

6.35 Surveys have also been used to gather information on intermediaries. An example can be found in the Impact Investing 2.0 initiative (see Box 6.5), in which 30 out of 350 funds analysed met the criteria to be considered social impact investment, and 12 were selected for in-depth analysis. The samples are small and not necessarily representative of the market, but these efforts are useful in helping to build the evidence base.

6.36 As noted earlier, associations and sector networks can play an important role as data providers. Establishing the parallel to the venture capital market discussed earlier in this paper, most of the current transaction data sources are venture capital associations (e.g. EVCA in Europe or NVCA in the US). These associations collect data directly from the venture capital firms. Some national angel investment associations also play a data collection role.

6.37 Even though data from some of these venture capital associations or angel investor networks can be fairly comprehensive, usually it only covers information obtained from members or associates. This caveat is even more important in areas where the association\network might only represent a small share of the market players. This is, for example, the case of business angel associations and networks. The case with SII is even more challenging given the varying views on definitions and the potential incentives for investors to classify themselves as social impact investors when they might not qualify. Rapidly growing SII-related associations such as Venture Philanthropy Associations (e.g. EVPA in Europe or AVPN in Asia) will certainly be important in future data collection efforts.

6.38 The main challenge in sourcing data from intermediaries is that it is usually collected to address investor needs. Data disaggregation, in terms of social areas, relevant to a policymaker might be very different from the breakout and labels that would be appealing to an investor. It is important to distinguish the data requirements of investors, researchers and policymakers as outlined in Section 6.2. For example, while data collected for investors should reflect mostly financial characteristics (e.g. risk-return profiles, investor perspectives and investor practices, track record), data for policymakers should make the link with social outcomes and collected in such a way to provide the basis for informed policy action. Further work is needed to obtain data in a way that can provide insights for policy guidance.

6.4. Current Approaches to Data Collection

6.39 Various approaches might be used to collect SII information depending on which parts of the market are being assessed. However, none of the currently available approaches are optimal. The first is a top-down approach where key national aggregates are identified that allow the estimation of the SII market conditional on (strong) assumptions. The second is to compile information from players that have a common legal form directly linked to SII. The third is to collect data via surveys from market actors. Data requirements can also vary depending on who is seeking the data (market players, academics, policy makers). The details, advantages and disadvantages of each approach are described below.

6.4.1. Top-down approach

6.40 Some of the components of the SII framework can be estimated using a top-down approach. Within this approach, the first step is to obtain data on national aggregates. Since this data are highly aggregated, it combines a myriad of different information sets that go beyond SII. Therefore, the key is to single out the SII components. For this exercise a number of (rather strong) assumptions are required. First, it requires that some (rough) idea of the shares of the SII component, which needs to be based either on perceptions or historical information.

6.41 While using shares based on perceptions can be misleading, depending on historical data assumes that it is: i) representative of the SII market; and, ii) there are no structural shifts, and thus percentages remain the same. On one hand, significant challenges still remain in terms of sizing the market. On the other hand, the SII market is evolving and growing rapidly, which means that assuming stable shares of the SII component might be unrealistic. In addition, it is important to note that even if shares provide a good representation of reality in one country, it will likely not be the case in different countries with different social systems. As a result, this approach has significant limitations. Although it can be useful to provide rough estimates of the market and foresights of demand and supply in the coming years, it does not allow effective measurement of SII demand or supply, nor is it able to provide insights into SII deal flows.

6.42 Examples of the use of this approach can be found in measurement exercises focusing on potential funding from institutional investors or funding from governments. As an example, work being carried out by NABs has provided information on the scope of public expenditures and public procurement based on National Accounts aggregates. The potential SII demand was identified by narrowing down to social service delivery funded by government. Another potential use of this approach is the measurement of potential investments by institutional investors as described in section 6.3.2.

6.4.2. Bottom-up approach

6.43 A different approach to sizing SII components is to focus on individual units (e.g. social enterprises, specific types of investors or intermediaries). This approach requires that sufficiently detailed information is available at a high level of disaggregation that allows identifying individual units within SII. Information to identify SII delivery organisations would include sector of economic activity, legal form, business description\mission, *inter alia*. This information could either come from NSO micro databases or from commercial data providers. As a second step, it is then essential to understand whether the individual units gathered represent the population or a subset of it. In the most likely case that it only represents a subset of the population, it is important to ensure that the sample is representative (e.g. through observing characteristics contained in the data). Finally, based on the information gathered, the SII component can be measured either through aggregation (if the population is observed) or by inference (if using a subset of the population).

6.44 The key challenge of using this approach is ensuring that either the whole population is observed or the sample is representative. Section 6.6 discusses sampling challenges at length. The emphasis given to NSOs derives from the fact that they usually provide information on a population set or at least on a representative sample. In addition NSOs have expertise in collection of high quality data in a consistent, cross country comparable way. The United Nations Handbook on Non-Profit Institutions in the System of National Accounts (UN, 2003) provides guidance for NSOs to identify and collect data on NPIs. An interesting feature is the practical solution to the measurement approach to non-market output (i.e. social impact). As a long term goal, it would be important to consider agreement on definitions and legal structures in such a way that (demand) data can be collected in a systematic and internationally comparable way by NSOs.

6.45 Examples of this approach can be found in efforts to size the demand side of the SII framework (specifically measuring the social enterprise sector). In a study of the Italian social enterprise sector, Fedele and Miniaci (2010) use commercial data sources (Amadeus database from Bureau van Dijk) to distinguish the capital structure of cooperatives (proxy for social companies) *vis a vis* for profit enterprises.

Box 6.4. Satellite Account on Non-Profit Institutions

The Satellite Account on Non-Profit Institutions (NPIs) was introduced to respond to a growing non-profit sector that was not taken into account in the agreed System of National Accounts (SNA 1993). The Handbook (UN, 2003) provides guidance regarding the identification of all NPIs, in particular through a clear definition of NPI, the valuation of volunteer work and by introducing a classification system for NPIs based on their function. The need for improved data coverage — insofar as there were no incentives for NSOs to collect data on NPIs — and the increased policy relevance, were also key motives for developing this system.

There are a number of distinctive characteristics in NPIs that required a specific statistical approach, different than the applied to corporations and governmental units. Some of these characteristics, such as the revenue structure, capital sources or tax treatment, can also be found in SII. By classifying NPIs into 12 group types (see Table A.6.1, Annex) and providing a system for categorising revenues and expenses as well as volunteer work, donations, as well as *non-market output*, the Satellite Account for NPIs provides a harmonised framework for mapping the NPI sector. Also, it provides data on the extent to which foundations fund other parts of the non-profit sector such as health or research

For the case of SII, it would be important to highlight the measurement of *non-market output*. While the traditional SNA measures output through sales revenue. For the case of some NPIs and SII, part of the output will not be measured this way and output will be undervalued. This is particularly the case if an organisation has a significant portion of its revenue coming from donations and other non-sales types of revenue. The measurement approach does not attempt to value non-market output. Instead, the valuation of non-market output is based on the difference between costs and sales. If negative the non-market output will be zero, if positive it will be equal to the difference between sales and costs. Even though this approach is not optimal, it provides a practical solution to the measurement issue.

Source: UN (2003).

6.4.3. Surveys

6.46 The most direct source of data is to conduct surveys of key actors in the market. Surveys can be very resource-intensive, but provide extremely rich information if well designed and implemented. The first step in a survey process is to identify key SII players — social enterprises, investors or intermediaries, depending on the SII component under analysis. This is challenging, since depending on the type of survey respondent, greater detail and data granularity can be achieved.

6.47 Recently, the OECD carried out a survey of Social Economy Organisations (SEOs), understood as organisations with non-profit objectives, operating in 14 different regions, corresponding to 8 countries (OECD 2013g). The geographical scope was limited, but the results insightful. The survey was answered by 655 SEOs and revealed that, on average, SEOs finance themselves mostly through internal resources — i.e. their “profit”\cash generating ability — (31.8%) and subsidies (30.6%). In addition, as the level of detail increases, so do survey costs.[28]

6.48 Second, survey design is crucial for efficiently and effectively achieving the objectives of the analysis. In designing surveys, it is important to reach the right balance between the amount of information requested and simplicity — i.e. respondents may feel less encouraged to complete the survey if it becomes too complex and time consuming. Also it is important to consider sampling frames to be able to know what part of the population is being surveyed (ensure representativeness). To date, most surveys on SII have focused on selected networks of key market players in certain geographies and therefore it is not clear whether the data is representative of the population.

28 . Sample size varied by region (between 16 and 145 SEOs). Response rates where unknown in many regions due to lack of information on the number of surveys distributed. Where available, response rates varied between 6.4% and 17.7%.

6.49 Survey response rates are often lower than initially expected. It is important to understand why there are non-respondents. Designing the appropriate incentives for reporting good quality data is essential. Moral hazard issues in previous data collection efforts were identified during the OECD SII Expert Meeting in Paris. Incentives should ensure that, for example, portfolio losses are reported in a rigorous way. In addition, it is important to note that incentives should be tailored to the type of SII player being surveyed. For example, showing respondents part of the survey outcomes could provide a good incentive to some types of respondents such as fund managers.

6.50 Third, data control and verification mechanisms are crucial to ensure high data quality standards. In some surveys carried thus far, data was checked through registration documents (e.g. Saltuk et al., 2011, 2013, 2014). Finally, building upon the sample collected while ensuring its representativeness, it is possible to draw broader conclusions about SII activity (inference making).

6.51 The CASE initiative on impact investing (CASE i3) provides good examples of surveys aimed at building the SII evidence base. Launched in 2010 it partners with different market players (social entrepreneurs, investors, academics and policymakers) in order to provide build the SII evidence base (Box 6.5). An interesting feature of this initiative is the simultaneous focus on the demand and supply sides of SII.

Box 6.5. CASEi3 work on building the evidence base

Case is a recent initiative launched in 2010 by the Center for the Advancement of Social Entrepreneurship (CASE), based at Duke University's Fuqua School of Business, US.

Within CASE i3, a number of surveys have been carried out, either focusing on social entrepreneurs or on investors. The surveys are done in partnership with B Lab (focusing on social entrepreneurship) and with GIIRS (aimed at impact investment funds). Two separate datasets on companies and impact funds are maintained by CASEi3. As of March 2013, the company dataset covered over 8000 for-profit impact entrepreneurs. In terms of the funds database, it covers a total of over $4.5Bn in AUM.

CASE i3 also runs a MBA on Impact Investing. This is an interesting approach that accrues benefits in terms of increased research capacity, since students are involved in consultancy and research work, while engaging with academics and practitioners in the field of Impact Investing.

Case i3 also has the capacity to commission research to outside academics and consultants which further enriches the contribution of the initiative to advancing the knowledge about the SII empirical base. In particular, it commissioned research in 2012 to work with the data collected on social entrepreneurs with the objectives of i) making comparative analysis of the effects of being a B-corporation and ii) improving the data collection mechanism (including streamlining the survey). A new call for research proposals is expected for September 2014 and will focus on analyzing the supply side data. A sample of the survey can be found online.

The data on funds has been used for a report (Clark et al., 2013), where 12 out of 12 major funds selected between 30 very successful Impact funds (out of initial list of 350 potential impact funds). These accounted for $1.3bn total assets.

Data collected includes proprietary information so it is only disclosed to the greater public at aggregated levels through a series of reports and working papers. Nevertheless B-corp profile information is made available and includes company general information and

Source : CASE i3 website at http://sites.duke.edu/casei3/

6.52 Since the beginning, CASE i3 has been collecting data via surveys on social entrepreneurs and impact funds, in collaboration with B-Corporation and GIIRS, respectively. The survey of demand side organisations is used to label companies as a B-corp (Box 6.6). Therefore, there is a high incentive for companies to report the data because they can benefit from the label. The survey has been being improved over time (will soon be in its third version) and efforts have been made to reduce the number of questions (above 100). Since the main goal is to profile companies, financial information is very scarce (only includes one variable on total revenue), which would be important for the purposes of estimating SII demand. Also, the focus is on for-profit organisations, so, again, it might not fully cover what is understood as SII (e.g. including NPIs; Cooperatives). CASE i3 has also commissioned research in 2012 to investigate the benefits of being labelled as a B-corp (this research is still ongoing). With this respect, the challenge is to have an unbiased and representative sample of B-corps and non-B-corps so that robust comparisons can be made.

6.53 The survey on the supply side provides information on fund performance that can then be linked to portfolio company data. The objective is to provide input for the GIIRS rating system that rates both funds and portfolio companies. The ratings do not result from financial performance but rather focus on the (potential) for social\environmental impact. The underlying survey and quality check procedures used in GIIRS follow the same structure as those used for B-corp but the survey questions and type of information requested is adapted to serve the rating purposes. The data reporting burden is shared between the fund and portfolio companies as both benefit from being rated.

6.54 Surveys are extremely resource intensive and entail significant challenges in terms of identifying appropriate samples. Population and sampling issues are discussed at length in Section 6.6. Developing a resource-efficient way to exhaustively map the SII market remains a challenge.

6.55 Scoping exercises and pilot surveys can provide valuable input to improving SII survey design. However, new survey initiatives should be made in collaboration with existing efforts, to build upon existing experience as well as avoid survey fatigue. This is particularly relevant at early stages of market development, when different organisations may end up collecting data simultaneously. To collect globally, cross-country comparable data, new survey instruments may be needed, but should be implemented in partnership with existing initiatives and provide a broader coverage of SII activity across countries.

6.56 Different data approaches might be more appropriate to size different parts of the SII market given its current embryonic state. For the demand side, bottom-up approaches that rely on some form of SII-related legal form or classification might be preferable; however, for investors a top-down approach could be sufficiently informative. However, surveys appear to be the best overall option at the moment — despite high costs, sampling issues and survey fatigue risks — since not much information on SII is available.

6.5. Current SII data and market estimation

6.57 The SII market and concepts are new in most countries, thus the evidence base is very scarce. Market estimates mainly come from industry reports, while some academics have focused on measuring the scope of SII activity. This process has been facilitated by the work of the National Advisory Boards set up by the Social Impact Investment Taskforce established by the G8 and new initiatives such as Expert Group on Social Entrepreneurship in EU or the CASE i3 in the US have helped building the evidence base and pushing forward the data discussion.[29]

29. Information on the Expert Group on Social Entrepreneurship can be found at: http://ec.europa.eu/internal_market/social_business/expert-group/index_en.htm

6.5.1. Academic literature building on SII data

6.58 Even though academic literature on social enterprises is large, academic literature on SII is relatively scarce. In particular, academic papers that attempt to measure the scope of SII are rare. Table 6.4 below provides examples of the academic literature that focus on gathering and analysis SII-related data.

6.59 In terms of market components, most of the advances in data analysis have been on the demand side. The academic literature on social enterprises is extensive. For example, international research networks specifically devoted to social enterprises (e.g. EMES; TEPSIE) have been established and contributed to advances in the understanding of the social enterprise sector.[30] Mapping of social enterprises (*lactu sensu*) exist for a number of countries. Smith and Rothbaum (2013) provide an overview of business demographics trends related co-operatives across several countries, including Canada, France, Germany, Italy, UK and US.

Table 6.4. Examples from academic literature

Article	Country	Data	Source
Alcock et al (2012)	UK	Case study (SEIF)	Survey covering 1653 companies (285treated+1368non-treated)
Lyon et al (2010)	UK	Case study (SEIF)	Survey –See Alcock et al (2012)
Nicholls (2010b)	UK	Rough UK Landscape	Different reports
Nicholls (2010a)	Global (focus UK)	Broad mapping	N\A
Anttonen and Haikio (2011)	Finland	Demand indicators in elderly-care sector	Documents provided by Min. Social Affairs and Health
Hazenberg (2011)	UK	15 SIFIs (out of 22 identified)	Interviews w\ fund managers
Florek (2013)	UK	Community interest companies	National Survey of Third Sector Organisations
Mendel and Barbosa (2013)	Global	Exchange platforms	Exchange platforms websites
Blazy (2011)	FRA; USA	Sizing social sector. SII in USA	Government sources for FRA (e.g. DARES). Reports and Gvt sources for US (e.g. CDFI Fund)
Wells (2012)	UK	Case study (Futurebuilders)	FBE Annual Review Data
Borzaga et al (2010-WP)	ITA	sample of 320 Italian social cooperatives	ICSI2007 database; see also Scalvini et al (2007)
Fedele and Miniaci (2010-WP)	ITA	2007 balance sheet data for 504 companies, of which 226 are cooperatives (proxy for social companies)	Bureau van Dijk – Amadeus.
Smith and Rothbaum (2013)	Global	Cooperatives	Canada: Rural and Co-Operatives Secretariat; France: Les Scop and INSEE Germany: DGRV; Geschäftbericht Italy: Census on Cooperatives UK: Co-operatives UK; US: University of Wisconsin Center for Cooperatives

Source: OECD, based on desk research.

30 . Information on the EMES network can be found at http://www.emes.net/. Information from the European project TEPSIE is available at http://www.tepsie.eu/.

6.60 The academic literature is not very prolific in terms of studies analysing and mapping investors and intermediaries. While some papers go into detail on a specific market component (e.g. Mendel and Barbosa, 2013 overview existing exchange platforms), others focus on case studies of specific instruments (e.g. Alcock et al., 2012 evaluate the impact of the SEIF in the UK). Therefore, the mapping of SII is always very incomplete. Recent research initiatives such as the CASE i3, described before in Box 6.5, are aiming at providing robust evidence on the SII market as a whole.

6.5.2. Industry reports

6.61 While there are few academic papers, an increasing number of industry reports have attempted to size the SII market. These reports look at the market from different angles and often use different definitions that may include different things. Many of these reports focus on certain countries, geographies or sectors providing a window into parts of the SII market but a fragmented and sometimes contradictory view on the overall market. Without a comprehensive picture — either in terms of market potential, effective demand\supply or actual transactions —, data collection efforts can result in significant biases.

6.62 A number of these reports build on the same few data sources and on limited evidence from case studies (and many of the same cases are used repeatedly). To date, most SII data obtained comes from surveys (e.g. Saltuk et al, 2011, 2013, 2014) and interviews that have been conducted by SII intermediaries, government agencies and/or consulting firms. Even though the information collected in these reports is a big step forward towards a better understanding of SII, sample sizes are often limited and estimates of the SII market often require strong assumptions.

6.63 A number of industry reports have provided some estimates on the actual (or potential) size of the SII market. Table 6.5 below provides examples of SII market estimates as well as a brief explanation of the approached followed. Few reports focus on actual transactions, rather measuring effective demand and (quite often) estimating the market potential and forecasting future market growth. These numbers should be regarded with caution since they rely on rather strong assumptions and the underlying market estimation effort entails a non-negligible number of challenges. The estimates presented in the table are just illustrative since the underlying data and methodologies are very different due to data availability in each country. Therefore, any comparison of estimates across reports should be avoided.

6.64 The strategies to collect data previously described can broadly be found in the existing industry estimates of the SII market. As an example, Weber and Scheck (2012) take a bottom-up approach to size the German SII market, by compiling information on a number of major SII investors. Specifically, they sum up the assets, investments and funding from BonVenture, the Social Venture Fund, Auridis gGmbH and the KfW funding. Therefore the estimates might be downward biased since not all SII players are included due to data collection challenges.

6.65 As discussed before, estimating the actual size of the market requires a different approach, as well as different data and respective sources. The strategy followed by Brown and Swersky (2012) to forecast future SII investment demand was the following. First, a number of key SII sectors were identified and further disaggregated into 26 subsectors. Second, the share of economic activity performed by social organisations was calculated for each subsector. Third, the capital requirements of social organisations were calculated by sector. Finally, by comparing present with future capital requirement (based on sector growth and capital depreciation assumptions), it is possible to calculate the investment needs and thus forecast future SII demand. The underlying raw data is obtained through a combination of a survey to 40 SII market players, interviews and publicly available data sources, in a mixed bottom-up (sector level) and survey approach.

Table 6.5. Some market estimates from industry reports

Report	Country \Region	Estimate \ MKT potential	Type	Approach	Estimate year
Brown and Norman (2011)	England	£165 million	Potential	Survey (78 SIFIs)	2010/11
Brown and Swersky (2012)	England	£750 million potential demand (£1bn in 2016)	Potential	Mixed, but essentially Bottom-up (starting from sector level demand)	2015
Saltuk et al (2014)	Global	USD 10.6bn commitments	Effective and Transactions	Survey (125 investors)	2013
Addis et al.(2013)	AUS	A$ 300m investment, A$2 billion AUM	Potential	Top-down	2012
Harji et al. (2014)	CAN	>CAN$1.6bn in AUM	Effective and Transactions	Survey & interviews	2013
Chua et al. (2011)	Asia	USD 44-74bn potential AUM	Potential	Bottom-up (starting from sector level demand)	2020
La Croix (2014)	FRA	EUR 6.02bn Solidarity-based AUM	Effective and Transactions	Member reporting	2012
Clark et al. (2013)	Global	USD 1.3bn total assets (12 funds)	Effective	Survey	2013
Weber and Scheck (2012)	GER	EUR 24m market volume	Effective	Bottom up (Sum of key SII investors)	2012
Hope Consulting (2011)	USA	USD 120bn (willingness to invest in high performing non-profits)	Potential	Survey (5,227 individuals; 873 investment advisors; 727 foundations)	2010
Freireich and Fulton (2009)	US	USD 26bn community investing	Transactions	N\A	2007

Notes: Estimate year refers to the date to which the estimate corresponds to (usually different from publication date). AUM stands for assets under management.

Source: OECD, based on desk research.

6.66 The pure survey approach is followed by Saltuk et al. (2014) and is described in Box 6.2. As previously discussed, the key for successfully estimating the SII market is to guarantee that the sample is representative of the target population and that selection biases are mitigated. These remain key challenges in nearly all SII surveys because the boundaries of the target population (and definition) are still blurry.

6.67 A common caveat found in most industry reports relates to the strategies employed to estimate the current (or potential) market. Strong assumptions, such as constant shares (across time and geography) for the SII component of more aggregate measures can induce significant biases. Also, it is sometimes assumed a nexus\relationship between SII demand and supply that is not self-evident. For example, Chua et al. (2011) first calculate a sector-level SII demand projection assuming that 5% to 15% of total demand in each sector is satisfied through SII. Second, building on the demand estimate, the SII total invested capital is calculated through a formula based on estimated profit margins (by sector), return on equity and average cost of capital.

6.68 An additional caveat found in some industry reports is an emphasis on case studies and\or a selection of very successful SII transactions, investors or social enterprises (e.g. Clark et al., 2013). In particular if such small (and biased) samples are built upon to draw conclusions on the evolution of the SII market. It should be noted however, that such reports do not claim to size the whole SII market, but rather provide a kick-start to the discussion on building the evidence base. Avoiding selection biases is crucial and to do so, it is crucial to include in the samples not only the best and the good, but also the not so well performing cases (Bloom and Clark, 2011). The right incentives need to be devised in order to ensure the survey participation of, at least a representative sample of the target population. Providing feedback on interim survey results can be a good incentive to increase survey participation (Bloom and Clark, 2011).

6.6. Challenges in SII data collection

6.69 Scoping and sizing the global SII market is an enormous challenge. There is no consensual definition across different geographies and, above all, market players and researchers involved in SII. This implies that most market estimates are not directly comparable. Data is not being collected in a standardised and systematic way.

6.70 Most importantly, the lack of a consensual definition creates enormous challenges in identifying the target population — i.e. what exactly is being measured. For example, the scope of SII demand cannot possibly be identified as long as the boundaries of SII delivery organisations are blurry. Sampling schemes avoid the need to capture information about the whole population by focusing on a representative subset. However, sampling requires a clear definition of the population along with a number of key observable characteristics. So, in the case of SII, even if a sampling frame is properly devised and a robust sampling methodology is used, it results in biased estimates because it is unclear what the population of interest should be in the first place. In other words, it is not possible to find a subset of the populations that, according to some observable characteristics, is representative of the population. Therefore, estimates of SII scoping exercises are usually biased towards certain sectors, instruments or investor types. Accordingly, extrapolating total market sizes based on limited and unrepresentative samples should be regarded with caution. Chapter 4 of this report provides a structure that helps defining SII, the basis for engaging in data collection efforts.

6.71 In most measurement exercises, a common error is to exclude data that could be relevant (Type I error). In the case of SII, focusing on a narrower scope can result in significantly incorrect measurements. For example in Clark et al. (2013) only a selected number of intermediaries were analysed. The coverage in the series of GIIN\JP Morgan investor surveys (Saltuk et al., 2011; 2013; 2014) has been increasing, which reveals that some important investors might be (or have been) left out.

6.72 However, the early stage of SII market development can potentiate another type of measurement errors: including data that is not relevant for SII (Type II error). For example, applying the working definition described in Chapter 4, some delivery organisations can be wrongly included as SII investees. As discussed in that section of the paper, some certified B-corps may not be included in the potential demand for SII, because some of the certified companies would not meet the other necessary eligibility criteria for SII. Another example can be found in the ASSB dataset in the UK, which samples social enterprises from all existing firms with less than 250 employees (see Section 6.3).

6.73 The lack of a statistical definition of SII means that data is embedded in other broader data categories. Disentangling what is the subset of information that corresponds to SII can be extremely challenging. For example, in top-down approaches very strong assumptions are usually required, as discussed earlier in this section. In addition there are several SII data layers (e.g. social need granularity) which add substantial complexity to the analysis. A more granular approach may require data collection efforts that are more resource intensive and might entail additional confidentiality issues. The trade-off between level of detail and comprehensiveness of the information should be taken into account when deciding to collect data. As an example, for the purpose of analysing SII transactions, survey respondents might include investor platforms or the investors themselves. While focusing on investors provides a greater level of detail, it multiplies the number of respondents, thus increasing data treatment and survey management needs.

6.74 Finally, a common challenge in data collection is clarifying why, what and for whom data should be collected. This is particularly important because different goals require different data types (and data sources). Having a clear goal for data collection and well-defined data requirements is crucial. Two types of measurement objectives were identified in the OECD SII Expert Meeting in London. On the one hand, it is important to further understand the evolution and behaviour of the SII market to inform policymakers of any regulatory adjustments that might be needed. On the other hand, data collection efforts should also serve to inform investors about SII market potentiality.

6.75 Priority should be given to capturing objective data before stepping into areas where definitions are not yet established and data is deemed subjective. This may apply to either demand, supply or transaction data. However, given that transaction data usually entails some information on both demand and supply, a thorough collection of this type of data can be a valuable starting point. In early stages of market development surveys can be a valuable tool. However, these are resource intensive and entail significant challenges in terms on ensuring representativeness. In the long run, data collection needs to be based on standardised reporting because, as the market grows, surveys will become increasingly expensive.

6.7. Possible Future Approaches for Data Collection

6.76 Different players are engaged in collecting data on SII components from different angles, with different approaches and using different definitions. The plethora of new initiatives and reports attempting to size the SII market is a positive trend and suggests growing interest in understanding SII. However it makes it harder to identify key sources of data and compare and consolidate estimates. In addition, effort duplication and data overlapping is a serious risk. Collaboration between those players currently involved in data collection efforts is key. Some steps in this direction are already being taken. For example, the "Social Investment Research Council" was recently created in the UK to consolidate research efforts and avoid duplication.[31] Also, efforts to increase data comparability across countries are being made through initiatives such as the GIIN or the work of the SIITF.

6.77 To ensure comparability across data collection efforts taking place in different geographies, metadata is crucial as it helps understanding what exactly is available and how detailed are currently available data. This is particularly relevant when SII definitions are not yet established. Moreover, transparency requirements can help moving towards common standards. Such transparency requirements might be burdensome on the different players involved in the market, but they necessarily come with a standardisation exercise, whose benefits can outweigh the costs. It is however important to note that standards might limit the scope for innovation. The right balance should be found so that the standardisation procedure does not gridlock the SII market and prevents it from further innovating and growing.

6.78 A system based on automatic reporting would bring some advantages in terms of coverage and quality of the data. Such data can then be complemented with further information collected via surveys for specific purposes. Data reporting can be very costly for companies (especially for small social businesses), investors, intermediaries, while a significant part of the data obtained might end up not being used. It is important to note that the direct benefits SII players accrue from reporting are relatively small, so the adequate incentive mechanism needs to be put in place.

6.79 Requiring certification is an approach that can work as an incentive for companies to make the effort to report. By being certified (see Box 6.6 for the case of B-corp certification procedure), social enterprises gain more visibility as was as it sends a positive signal to potential investors. The certification procedure by B-corp is burdensome as it involves a survey, an interview, request for documentation and random checks, but it guarantees high data quality standards.

31. The Social Investment Research Council is a joint venture between Big Society Capital, Big Lottery Fund, City of London, Citi and the Cabinet Office.

6.80 Certification can also have positive effects in terms of more formalised outcome measurement practices that support the development of the SII market. However, from the viewpoint of businesses, certification can significantly increase reporting costs, thus the benefits of a move towards more stringent certification procedures should also be balanced against the increased regulatory burden. The certification requirements necessarily need to be mandated by public authorities in each country and possibly coordinated internationally. Public authorities can also play a role though regulation because it necessarily implies a standardisation exercise. Since SII is a new concept, data collection agencies, regulators and authorities have not yet developed standardised and internationally comparable definitions and classifications that would allow a systematic collection of data.

Box 6.6. Certification & labels: B-corp example

B-Corporation is a NPI that certifies for-profit companies according to their practices in terms of achieving social impact. The certification is based on a set of company information obtained through an online survey (done in collaboration with CASE i3, Box 6.5). Scores are attributed to companies according to a previously set methodology that values survey answers (thus company characteristics) differently through a weighting procedure.

For example a question on the commitment to achieve social impact embedded in the company's mission is given a higher weight than a different question regarding stakeholder engagement. Other characteristics include different indicators on transparency, reporting, treatment of employees, work environment, the type of impact, targeted populations, community involvement and impact, *inter alia*. In total, around 130 company characteristics are surveyed through an equal number of questions.

Base on the set of predetermined scores, companies are profiled and evaluated across the different set of characteristics, after which they are given a final overall score that will be the basis for the eligibility to become a B-corp (above a certain global score threshold. To become a B-corp, companies are also required to make amendments to the articles of incorporation, explicitly recognising the importance of other stakeholders beyond shareholders. A snapshot of the profile information is provided in the table below. After a there is a clarification procedure through which B-corp reviews the data provided together with the company. This and further quality checks (e.g. requests for official documents) are time and resource consuming, but help ensuring that the data is accurate.

Table. Snapshot of the B-corp profile information

Name	City	State	Industry	Overall Score	Accountability	Beneficial Method	Local Community
***	San Francisco	CA	NULL	137.4	16.8	NULL	NULL
***	Poulsboro	WA	Consumer Products & Services: Housewares	NULL	NULL	NULL	NULL
***	Richmond	BC	NULL	NULL	NULL	29.7	2.1
***	Vancouver	BC	Technology: Information Technology Serv.	NULL	NULL	NULL	NULL
***	Belvedere	CA	NULL	NULL	NULL	50.7	5.2
***	Philadelphia	PA	NULL	83.5	8	27.2	6.1
***	Fremont	CA	NULL	145.2	23.6	NULL	NULL
***	Haleiwa	HI	NULL	88.1	7.5	NULL	NULL

Note: Only four variables out of 133 are shown here. The variable *Overall Score* is an aggregation of the 133 scores. The names of the companies are omitted here for anonymity purposes. The maximum score is 200 and only companies over the 80 points threshold can be considered a B-corp.

Source: B-Corp Profile information available at: http://sites.duke.edu/casei3/files/2013/03/B-Corp-Profile-Information.xlsx
Source: B-Corporation website, available at : http://www.bcorporation.net/

6.81 Certification may also evolve to a rating system. GIIRS is a recent initiative that aims at working as a rating organisation specialised in SII (see Section 6.4.3 for details on GIIRS data collection).[32] Such an approach is very important because it allows increasing informational efficiency, insofar as the creation of an additional layer of information asymmetry is avoided.

6.82 Benchmarking is regarded to be one important but challenging aspect for investors in SII (Saltuk et al., 2011). Currently, it is very difficult to assess the risk-return profile of a social impact investment. For investments in mainstream capital markets, several indexes exist, against which asset performance can be benchmarked. However, in SII performance measures go beyond the common valuation of expected returns and foreseeable risks. Social outcomes create a wedge between the private pecuniary outcome and the benefits that accrue the larger society.

6.83 It is important to allow investors to factor social impact into investment decisions, while rating systems should help clarifying and tracking impact risk (WGAA, 2014). Both social impact and impact risk should feature in a benchmark for SII. A number of initiatives such as GIIRS or Engaged X have been working towards creating benchmarks for the SII market that incorporate metrics for social impacts and access risks.

6.84 Further work to develop robust and comparable impact measurement practices (in delivery organisations and for investors) can also help building the evidence base. The Impact Measurement working group set a number of principles required to work towards an "impact measurement convention" in the future. This would ensure a standardised approach for impact measurement and envisage a reporting system that ensures the availability of quality impact data (WGIM). The governance model of such process is however not yet clear. This would in principle entail a commitment from governments and industry to set up a working group with representatives from governments and industry and a steering committee that would agree upon the common impact measurement language, guidelines, and data infrastructure. International organisations could provide the appropriate forum for such discussion.

6.85 As the SII market continues to grow in the future, commercial data providers that provide information for investors might be increasingly interested in compiling SII information if selling SII data becomes a viable business. Some of these commercial data providers have already seen value in gathering information on certain SII-related components. For example, Factset compiles information on the NPI sector, despite there is a very strong geographical bias towards the United States.[33] Given the embryonic state of the SII market, the policy relevance of SII models and the role that Governments might play in these initial stages, it would be important that efforts are made to collect (and share) systematic data within an open-data approach.

6.86 Alternative strategies to gathering SII data were also discussed at the OECD SII expert meetings. These included polls, community feedback mechanisms and tapping into big data. Even though these approaches can provide rich and extensive information, data quality control and verification is extremely challenging.

32. Information available at http://giirs.org/

33. A dataset obtained from Factset comprises 14 363 NPIs of which 97% are based in the United States. Over 89% are owned by another NPI, around 9% by foundations and the remaining 2% by other types of companies (notoriously business ventures in the private sphere). Even for the United States, this dataset only represents about 2% of the total number of *Organizations Eligible to Receive Tax - Deductible Charitable Contributions* (IRS, available at: http://apps.irs.gov/app/eos/forwardToPub78Download.do).

6.87 Collecting data is costly and its value is often not fully appreciated by the industry and\or policymakers. While costs should be minimised and data collection efficiency strived for, it is clear that further resources should be deployed into gathering the evidence base. For example, small grants or lottery-type prizes can be provided as an additional incentive for organisations to report data (Bloom and Clark, 2011). The efforts need to be made jointly between all SII market actors. Better data would be important for delivery organisations that would get more visibility, investors that would know better where to allocate their money, intermediaries that would be able to provide a better offer of investment products, as well as policymakers to fully understand whether the SII model is superior and should be further supported and incentivised.

6.88 Providing comprehensive information can be a significant burden for delivery organisations. However, requiring specific information (e.g. impact measurement) for funding purposes is a key incentive for investee reporting that can be aligned with investor interests. Further efforts are needed to embed a data reporting culture in delivery organisations – and also in supply side organisations and intermediaries. Incentives for investor reporting, likely via intermediaries or investors networks, can include disclosure of part of the available data or even granting access to a dataset on potential SII investment. Also, ensuring that investors report actual (instead of potential) returns is essential to guaranteed data reliability. Incentives based on data exchange arrangements can also be important to bring SII intermediaries together in a platform or a network for data exchange.

6.89 Data collection also requires technological infrastructure. It is important to have a simple infrastructure where all data can be put in. A possible way to further advance on data collection and comparability in the long run could be to work towards creating a platform in which players currently engaged in data collection (from the different parts of the SII framework) could come together and share information.

6.90 At a first stage, increased collaboration among a few key players through meetings to share experience and data can contribute to further advancing the understanding about the SII market. At the OECD SII Expert Meetings it was noted that the group of experts could be drawn upon to help move beyond proprietary data, generate consensus and have a "clear" model for data collection. It would be important that data shared in such platform is made freely available on an open-source basis, keeping in mind that organisations collecting data also have to appropriate some value from their efforts.

6.91 Optimal data on SII is currently not feasible to obtain, but it is important to push the discussion forward. It is however important to bear in mind that data collection should not become an end in itself and the purposes for data collection need to be *a priori* clear. The bulk of systematic evidence on SII will likely come from private data sources in earlier stages of market development. Fostering the collaboration between the different organisations collecting SII data through in surveys, polls and other approaches is key. While reaching a common understanding about definitions is vital, agreeing on a methodology to collect comparable cross-country data could provide the evidence base for a better understanding of the SII market. It can also help in the analysis of the role that policymaking can play in this area. Drawing upon private and other types of finance to meet public objectives is an opportunity, but one which requires a good understanding of the incentives of the different players involved.

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ANNEX 6.1. LIST OF EXISTING DATA SOURCES

This list of data sources only includes organisations that currently provide raw data on SII. Therefore, only organisations that actually provide either raw data or data in reports were included on the list. Organisations that may have important links to SII market players and could potentially serve as partners in future data collection efforts are not necessarily included on the list, insofar as they do not currently provide data.

In addition, some of the data sources described as currently providing raw data do not necessarily publicly disclose the information. Nevertheless, they feature on the list because information could, in principle, be shared under certain conditions. Some organisations have been collecting data, but have not yet disclosed any data-related information (e.g. Maximpact). In such cases a decision to include them on the list was based on the fact they have data and will potentially be disclosing it in the near future.

Governmental sources, information from NSOs and sources available from financial system supervisory and regulatory bodies were not included here to avoid multiple entries (one per country for each type of organisation). The list focuses on data that are, in general, more challenging to obtain and that require further discussion and contribution from SII data experts. Nevertheless, the potential of data collection from some of the sources omitted in the list is also discussed in this note.

Provider	**Type of data (ecosystem)**	**Geography**	**Link**
SESS	Demand	CAN - local	http://www.sess.ca/english/report/
TEPSIE	Demand	Europe	http://www.tepsie.eu/
Cooperative Association Germany	Demand	GER	http://www.dgrv.de/en/home.html
ClearlySo	Demand	Global	http://www.clearlyso.com/about/our-publications.html
Social Progress Imperative	Demand	Global	http://www.socialprogressimperative.org/
IRIS	Demand	Global - focus US; UK	http://iris.thegiin.org/
B-Corporation	Demand	Global- focus USA	http://www.bcorporation.net/what-are-b-corps/why-b-corps-matter
Unicredit	Demand	ITA	http://www.forumterzosettore.it/multimedia/allegati/Ricerca.pdf
IRIS (Italian)	Demand	ITA	http://www.irisnetwork.it/download/
CIC regulator	Demand	UK	http://www.bis.gov.uk/CICREGULATOR
Social Enterprise UK	Demand	UK	http://www.socialenterprise.org.uk/policy-campaigns/policy/research
CASE at Duke University	Demand	USA	http://sites.duke.edu/casei3/case-i3-basics/case-i3-research/case-i3-b-lab-and-giirs-research-project/
Nonprofit Finance Fund	Demand	USA	http://nonprofitfinancefund.org/tools-resources
Comparative non-profit sector project	Demand	Global	http://ccss.jhu.edu/research-projects/comparative-nonprofit-sector
Social Enterprise Alliance (SEA)	Demand	USA	https://www.se-alliance.org/
Australian Charities and Not-for-Profits Commission (ACNC)	Demand	AUS	http://www.acnc.gov.au/
GIIRS	Demand & Supply	Global	http://giirs.org/for-investors/company-directory http://giirs.org/for-investors/fund-directory
Caisse des Depots	Intermediaries\Transactions	FRA	http://www.caissedesdepots.fr/activite/domaines-daction/investissements-davenir/financement-de-leconomie-sociale-et-solidaire.html
Finansol	Intermediaries\Transactions	FRA	http://www.finansol.org/fr/nos-publications/article/le-barometre-de-la-finance-solidaire.html
Bpifrance	Intermediaries\Transactions	FRA	http://www.bpifrance.fr/
NExT SSE	Intermediaries\Transactions	GER	http://www.nextsse.com/home/news-events/
Impact Assets	Intermediaries\Transactions	Global	http://www.impactassets.org/
Monitor institute	Intermediaries\Transactions	Global	http://monitorinstitute.com/what-we-think/#
Omydiar Network	Intermediaries\Transactions	Global	http://www.omidyar.com/

GIIN/Impact Base	Intermediaries\Transactions	Global	http://www.impactbase.org/
JP Morgan\GIIN	Intermediaries\Transactions	Global	http://www.thegiin.org/cgi-bin/iowa/download?row=334&field=gated_download_1;
Maximpact	Intermediaries\Transactions	Global	http://www.maximpact.com/
Engaged investment	Intermediaries\Transactions	Global	http://www.engagedinvestment.com/
Toniic	Intermediaries\Transactions	Global	http://www.toniic.com/
TRIODOS Bank	Intermediaries\Transactions	Global- focus Europe	http://www.triodos.com/en/about-triodos-bank/
Oltreventure	Intermediaries\Transactions	ITA	http://www.oltreventure.com/index.php/investimenti/riepilogo
BSC- Big Society Capital	Intermediaries\Transactions	UK	http://www.bigsocietycapital.com/
Comunity Development Finance Association (CDFA)	Intermediaries\Transactions	UK	http://www.cdfa.org.uk/
CDFI FUND	Intermediaries\Transactions	USA	http://www.cdfifund.gov/
Massolution	Intermediaries\Transactions	USA	http://www.massolution.com/
National Community Investment Fund (NCIF)	Intermediaries\Transactions	USA	http://www.ncif.org/
Instiglio	Intermediaries\Transactions		http://www.instiglio.org/en/sibs-worldwide/
EVPA	Intermediaries\Transactions	Europe	http://evpa.eu.com/knowledge-centre/
AVPN	Intermediaries\Transactions	Asia	www.avpn.asia
Impact in Motion	Supply & Intermediaries\Transactions	GER	http://impactinmotion.com/en/
Philantropy Australia	Supply	AUS	http://www.philanthropy.org.au/tools-resources/publications/
Productivity Comission	Supply	AUS	http://www.pc.gov.au/publications/publications?queries_by_type_query=Publication
European Foundation Centre	Supply	Europe	http://www.efc.be/programmes_services/resources/Pages/Foundations-in-Europe.aspx
Fondation de France	Supply	FRA	http://www.fondationdefrance.org/Outils/Mediatheque/Etudes-de-l-Observatoire
Centre Francais de Fonds et Fondations	Supply	FRA	http://www.centre-francais-fondations.org/ressources-pratiques/gerer-ou-faire-vivre-un-fonds-ou-une-fondation/gestion-patrimoniale/gestion-financiere/vers-de-nouveaux-modes-de-selection-des-placements/impact-investing
Association of German Foundations	Supply	GER	http://www.stiftungen.org/en/association-of-german-foundations.html
ACRI	Supply	ITA	http://www.acri.it/3_fond/3_fond0010.asp
The Japan Foundation Center	Supply	JAP	http://www.jfc.or.jp/eibun/e_index.html
GOV_UK	Supply	UK	http://data.gov.uk/dataset/social-investment-and-foundations
Association of charitable foundations	Supply	UK	http://www.acf.org.uk/
Foundation Center	Supply	USA	http://fconline.foundationcenter.org/
Impact Investing Australia	Overall	AUS	http://impactinvestingaustralia.com/resources/
Purpose Capital	Overall	CAN	http://purposecap.com/
MaRS Centre for Impact Investing	Overall	Global	http://impactinvesting.marsdd.com/
IIPC	Overall	Global	http://iipcollaborative.org/about-iipc/iipc-research-awards/
Pacific Community Ventures	Overall	Global	http://www.pacificcommunityventures.org/uploads/reports-and-publications/
Stanford Social Innovation Review	Overall	Global	http://www.ssireview.org/topics/category/impact_investing
Social Impact Analysts Association	Overall	Global- focus EU; CAN	http://www.siaassociation.org/
BCG	Overall	Global- focus UK	http://www.bcg.com/expertise_impact/PublicationDetails.aspx?id=tcm:12-115600&mid
The City of London	Overall	UK	http://www.cityoflondon.gov.uk/business/supporting-local-communities/Pages/supporting-social-enterprise.aspx
OECD	Demand, Supply & Enabling environment	Global- focus OECD	http://stats.oecd.org/
IMF	Supply	Global	http://www.imf.org/external/data.htm
World Bank	Demand, Supply & Enabling environment	Global	http://data.worldbank.org/
World Values Survey	Enabling environment	Global	http://www.worldvaluessurvey.org/wvs.jsp
European Social Survey	Enabling environment	Europe	http://www.europeansocialsurvey.org/
Eurofund	Enabling environment	Europe	http://www.eurofound.europa.eu/publications/htmlfiles/ef1361.htm
Social Progress Imperative	Enabling environment	Global	www.socialprogressimperative.org/data/spi

Source: OECD, based on desk research.

ANNEX 6.2. LIST OF OECD DATA SOURCES RELEVANT TO SII

Database	Type	Examples	Link
Social expenditure	Spending	Public\Private expenditure Cash\Kind expenditures Breakdown by social area	www.oecd.org/els/social/expenditure
Institutional investor statistics	Supply	Financial assets	http://stats.oecd.org/Index.aspx?DataSetCode=7IA#
How's Life Indicators	Needs	Quality of support network; Homicide rate	http://stats.oecd.org/OECDStat_Metadata/ShowMetadata.ashx?Dataset=BLI&ShowOnWeb=true&Lang=en
Tax/Benefits	Spending	Social contributions; Housing benefits	http://stats.oecd.org/BrandedView.aspx?oecd_bv_id=tax-data-en&doi=data-00201-en
Social indicators	Needs	Old age support rate; Prison population	http://www.oecd.org/els/soc/societyataglance.htm
National Accounts	Spending	NPIs serving households	http://www.oecd.org/std/na/
Health Indicators	Spending + Needs	Financing health expenditure Life expectancy; Infant health	http://stats.oecd.org/index.aspx?DataSetCode=HEALTH_STAT
Education Indicators	Spending + Needs	Expenditure by funding source Literacy scores Education expenditure	http://stats.oecd.org/BrandedView.aspx?oecd_bv_id=edu-data-en&doi=edu-db-data-en ; and http://gpseducation.oecd.org/IndicatorExplorer
Product Market Regulation	Regulation	Scope of Government in specific sectors Specific barriers to entrepreneurship	http://www.oecd.org/economy/growth/indicatorsofproductmarketregulationhomepage.htm
Entrepreneurship Indicators	Demand	Entrepreneurial culture	http://www.oecd-ilibrary.org/industry-and-services/entrepreneurship-at-a-glance-2013_entrepreneur_aag-2013-en
Structural Indicators	Supply Demand	Financial sector (C65T74) Community, social and personal services (C75T99)	http://www.oecd.org/sti/ind/stanstructuralanalysisdatabase.htm
Financing Scoreboard	Supply	Trends in SME loans Government Guarantees	http://www.oecd-ilibrary.org/industry-and-services/financing-smes-and-entrepreneurs_23065265
Development co-operation	Supply	Flows: Project-type interventions	http://dotstat.oecd.org/inventory.aspx?datasetcode=TABLE1
Development aid	Supply	Aid	http://www.oecd.org/dac/stats/
Network of Foundations	Supply	Foundations	http://www.oecd.org/site/netfwd/

Source: OECD.

Table A.6.1. Types of Non-Profit Institutions

1. Culture and recreation	1 100 Culture and arts
	1 200 Sports
	1 300 Other recreation and social clubs
2. Education and research	2 100 Primary and secondary education
	2 200 Higher education
	2 300 Other education
	2 400 Research
3. Health	3 100 Hospitals and rehabilitation
	3 200 Nursing homes
	3 300 Mental health and crisis intervention
	3 400 Other health services
4. Social services	4 100 Social services
	4 200 Emergency and relief
	4 300 Income support and maintenance
5. Environment	5 100 Environment
	5 200 Animal protection
6 Development and housing	6 100 Economic, social and community development
	6 200 Housing
	6 300 Employment and training
7. Law, advocacy and politics	7 100 Civic and advocacy organizations
	7 200 Law and legal services
	7 300 Political organizations
8. Philanthropic intermediaries and voluntarism promotion	8 100 Grant-making Foundations
	8 200 Other philanthropic intermediaries and voluntarism promotion
9. International	9 100 International activities
10. Religion	10 100 Religious congregations and associations
11. Business and professional associations, unions	11 100 Business associations
	11 200 Professional associations
	11 300 Labour unions
12. Not elsewhere classified	12 100 Not elsewhere classified

Source: UN (2003).

7. POLICY ACTIONS AND IMPLICATIONS

This chapter provides an overview of different types of policy actions to support the Social Impact Investment market taken to date. It reviews the challenges for policymakers planning to take actions to support this nascent field and makes recommendations focusing on the steps required to build the evidence base. These including developing common definitions, building the necessary data infrastructure and primary impact measurement as well as evaluation of broader social outcomes.

7.1. Policy Actions and Implications

7.1 There are a number of market failures in social impact investment. The most fundamental failure relates to the very nature of social impact investment. The social returns generated from social impact investments are primarily external to both the investor and the investee, with the primary beneficiaries being those groups whose needs are being targeted, or accrue to society as a whole. Given market inefficiencies, these externalities are not priced into social impact investment transactions (HM Government, 2011).

7.2 However, in addition to this there are failures which relate to the functioning of the market itself. 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 impact 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 intermediaries in the form of brokers, advisors, exchanges and other market mechanisms.

7.3 The public sector can play a catalytic role in the social impact investment market in terms of creating a conducive regulatory environment, encouraging greater transparency and taking concrete steps to help develop the market. 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.

7.4 New and\or inefficient markets may benefit from government involvement. Certainly, the social impact 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.

7.2. Policy actions to date

7.5 There are various actions that governments could take to support SII, ranging from indirect to direct. Indirect actions can include ensuring that the necessary legal frameworks and structures are in place including the streamlining of regulations and requirements for investment (Thornley et al, 2011). Direct actions can include various forms of support to social ventures and facilitating the developement of intermediaries. It should also be noted that, the absence of any action can also have implications for the market.

7.6 The Impact Investing Policy Collaborative (IIPC) has developed a framework which aims to create a guide for policy makers seeking to build the social impact investment market in their countries or communities. This includes looking at the government's role as a market builder, participant and steward. The framework builds upon earlier work by the World Economic Forum (WEF, 2012) as well as upon *The London Principles*[34], a set of guidelines intended to assist governments considering impact investing as a tool to address social objectives, developed by the IIPC in collaboration with policymakers, researchers and other stakeholders in July 2013.

7.7 The recent Social Impact Investment Taskforce and National Advisory Board reports highlighted actions that have been taken to date in the G7 countries and Australia.[35] Annex 7.1 summarises some of these policy actions. Table 7.1 below attempts to provide a summary of the longer list of policy actions outlined in Annex 7.1 within the framework of the social impact investment ecosystem discussed in Chapter 3 (demand, supply, intermediaries and regulatory/enabling environment).

Table 7.1 Examples of Types of Policy Actions taken in G7 Countries and Australia

Supply	Demand	Tax & Regulation	Intermediaries	Other
Social Enterprise Development and Investment Funds (Australia)	Social Innovation Forum (Japan)	Loi n° 2014-856 : Économie Sociale et Solidaire (France)	SVX trading platform (Ontario, Canada)	Unit Cost Database (UK)
Small Business Investment Company Impact Investment Fund (US)	Investment and Contract Readiness Fund (UK)	Legge delega di riforma del Terzo Settore (Italy)	Big Society Capital (UK)	Community Reinvestment Act (US)

Source: OECD, based on National Advisory Board (NAB) reports — NAB_AUS (2014), NAB_CAN (2014), NAB_GER (2014), NAB_FRA (2014), NAB_ITA (2014), NAB_JAP (2014), NAB_UK (2014), NAB_US (2014).

7.8 Policy actions in some of these countries have addressed regulatory issues, notably in terms of setting up legal structures to accommodate SII-specific types of market actors. Also, several policy interventions have sought to enhance SII supply. Some governments have provided support through tax credits (and tax-advantaged funds), guarantees or subsidies, established and co-invested in SII funds. Other governments have focused on developing the social impact investment market infrastructure through the creation of intermediaries such as SII wholesale banks, exchanges (or trading platforms) and other channels to facilitate the links between supply and demand for SII (investors and delivery organisations). Additionally some have sought to stimulate SII demand by providing support to delivery organisations/investees through technical assistance or by encouraging procurement.

34. http://iipcollaborative.org/london-principles/

35. For further details on these policy actions see: http://www.socialimpactinvestment.org/

7.9 While there have been an increasing set of policy actions in the social impact investment market, to date, there have only been a few evaluations, including the ICRF evaluation referenced in Chapter 3 and the SIB evaluation described later in this chapter. This is also due to the fact that many of these policy actions are relatively new. The Social Impact Investment Taskforce and the NABs have helped to highlight the set of existing policy actions which has facilitated discussions about how these and other policies are working.

7.10 There are also several policy instruments that, while affecting SII, do not necessarily target the SII ecosystem (e.g. seed funds; regulations on institutional investors' asset allocation and risk). When devising broader policy instruments, it is important that governments take into consideration potential favouring or hindering effects upon the SII market and balance them against expected outcomes in other areas of the economy.

7.11 Patience and long-term support is needed to develop a 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.

7.12 Given the plethora of recent reports outlining a broad set of policy recommendations (SIITF, Working Groups, NABs, IIPC, etc.), the recommendations below address how to build the evidence base, which is the overall focus of this report.

7.3. Recommended policy actions for building the evidence base

7.13 As social challenges mount and existing approaches are unable to keep up amidst continued pressure on government budgets, social impact investment provides an opportunity to develop new approaches to address social and economic challenges. However, given that SII is a nascent field, concrete evidence is needed in terms of its impact to date. In particular, further work is needed to demonstrate the gains from the SII approach, compared to existing social service delivery models. Therefore our recommendations focus on building the evidence base, including developing a common agreement on definitions, committing to building the necessary infrastructure for coordinated data collection processes, furthering efforts on the measurement of social outcomes and evaluation of policy.

7.14 Given that additional, and more effective, funding is needed to address the increasing social challenges facing society, governments in a number of countries are demonstrating interest in exploring the opportunities that SII could also provide in terms of improved social service delivery. In fact, as described in Section 7.2, some countries have already set up policies to facilitate the development of SII markets. As there is limited evidence to date in terms of what works and what doesn't, this section outlines some recommendations in terms of building the evidence base and suggestions regarding key points for policy makers to keep in mind, particularly in terms of outcome measures and evaluation of policies. Further analysis is needed in terms of specific approaches to SII, looking at a variety of instruments and sector-specific developments. This would help develop a better understanding of which approaches seem to be working and help build and share experiences which could later lead to the scaling up of successful cases.

7.3.1 Developing common definitions

7.15 A stronger evidence base, both in terms of the level of market activity as well as the impact of SII, 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.

7.16 As outlined in Chapter 4, there is broad agreement in the market regarding the core characteristics of SII, however, less agreement on the next level of detail, the key attributes of each of the characteristics. More importantly, there has been little discussion to date of where to "draw the line" on SII in terms of thresholds or eligibility of the various attributes. Chapter 4 of this paper makes some recommendations but further discussion is needed, on an international level, to develop a common agreement. To that end, international organisations, such as the OECD, can provide a continued forum for debate.

7.3.2 Building the necessary data infrastructure

7.17 Policy makers can help in raising awareness and understanding about social impact investment by supporting systematic research and data collection. However, while a growing number of industry reports have been supported, not enough attention has been paid to date on supporting the necessary data infrastructure needed to develop standardized data reporting and collection processes. These are critical for building the evidence base for SII and the groundwork needs to be laid for this as early as possible.

7.18 More and coordinated data collection is needed to more effectively 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. The OECD expert meetings, which took place during 2014, were a start in this direction as the meetings brought together people involved in data collection efforts from a number of countries and focused on how to move the agenda forward in a coordinate manner.

7.19 As noted in the section above, consensus is first needed on definitions to enable the building of an agreement on a common framework for data collection. A commitment of resources is then needed to invest in the necessary infrastructure to collect transaction level data. Trusted intermediaries will play a critical role in facilitating that data collection. The questions revolve around who should fund and also who should manage that data infrastructure. Finally, models and systems will be needed to analyse the data to provide the necessary evidence on what works.

7.20 It is however important to bear in mind that data collection should not become an end in itself and the purposes for data collection need to be *a priori* clear. The bulk of systematic evidence on SII will likely come from private data sources in earlier stages of market development. Fostering the collaboration between the different organisations collecting SII data through in surveys, polls and other approaches is important. While reaching a common understanding about definitions is vital, agreeing on a methodology to collect comparable cross-country data could provide the evidence base for a better understanding of the SII market. It can also help in the analysis of the role that policymaking can play in this area.

7.3.3 Primary impact measurement

7.21 SII targets the delivery of social outcomes at the same time as targeting financial returns (at least a return on capital): one without the other does not qualify as SII. Therefore the need for effective, robust and repeatable measurement of social outcomes is critical for social enterprises and investors. However developing effective, robust and repeatable measurement of social outcomes is easier said than done, and is certainly not as simple as calculating annual profits, especially when targets are part of the process (as in the case of SIBs). The social outcomes selected, measured and evaluated affect how attractive the enterprises is to financers, the business model used, how its practices encouraged or discouraged, internal decision-making, its level of cost effectiveness, and all together, the value of and regulation of SII practices as a whole. In short, getting it right is critical.

7.22 Particularly as global interest and activity in social impact investment is growing rapidly, better metrics for measuring at least primary (or "predetermined") social impact is needed. However, social benefits are difficult to value, measure and compare. In addition, the process of tracking and measuring these returns can be costly in terms time and resources.

7.23 The objectives behind measurement can differ for various stakeholders. Currently, SII measurement is focused on the achievements of the social delivery organisations. This information is helpful in evaluating the progress of the social ventures 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).

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

7.25 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 and one of the working groups of the international Social Impact Investment Taskforce has recently published a set of guidelines (WGIM, 2014), including an "impact value chain"(see figure 7.1 below).

Figure 7.1. WGIM Guidelines for impact measurement

	Guideline	Description
Plan	Set goals	*Articulate the desired impact of the investments* Establish a clear investment thesis/Theory of Value Creation[11] (ToVC) to form the basis of strategic planning and ongoing decision making and to serve as a reference point for investment performance
Plan	Develop Framework & Select Metrics	*Determine metrics to be used for assessing the performance of the investments* Develop an effective impact measurement framework that integrates metrics and outlines how specific data are captured and used; utilize metrics that align with existing standards
Do	Collect & Store Data	*Capture and store data in a timely and organized fashion* Ensure that the information technology, tools, resources, human capital, and methods used to obtain and track data from investees function properly
Do	Validate Data	*Validate data to ensure sufficient quality* *Verify that impact data is complete and transparent by cross-checking calculations and assumptions against known data sources, where applicable*
Assess	Analyse Data	*Distill insights from the data collected* Review and analyse data to understand how investments are progressing against impact goals
Review	Report Data	*Share progress with key stakeholders* Distribute impact data coherently, credibly, and reliably to effectively inform decisions by all stakeholders
Review	Make Data-Driven Investment Management Decisions	*Identify and implement mechanisms to strengthen the rigor of investment process and outcomes* Assess stakeholder feedback on reported data and address recommendations to make changes to the investment thesis or ToVC

Source: WGIM (2014)

7.26 The measurement of primary social impact is important for the market functioning (so demand and supply can more effectively communicate about return expectation and results) and has been the focus on impact measurement efforts to date. However, a better understanding of the broader or “secondary” social outcomes (spillover effects and positive externalities) and how social goods are delivered is also needed to fully determine the impact of social impact investment and assist policy decision making. As highlighted in Chapter 3, social outcomes can range from an individual to a society level. Also, the efficiency of interventions can either be at the individual level or more systemic. In addition, as discussed in Chapter 5, actions in one social area can have positive or negative spillovers in others and therefore need to be taken into account in a systemic approach. The next section addresses this broader approach.

7.4. Evaluation of Broader Social Impact Investment Outcomes

7.27 The need for better evaluations of social impact investment outcomes for informing decisions in the area of SII, and its regulation, cannot be understated. What works can have long lasting effects on people’s lives, and is part of the picture that determines the need for costly future social interventions. Yet, there are too few good quality evaluations suitable for informing market participants and policy makers about ‘what works’, and most importantly ‘how’ new policies and social innovations might be implemented.

7.28 While the context in each country is different and therefore the approaches will vary, we have outlined three key areas which might both make the market function more efficiently and help to evaluate the role of SII in meeting social needs, and thus the extent to which it should be supported through policy incentives. The first area is the development of relevant social outcome measures, that capture quality of life measures and their changes in both in the population (to identify need), and amongst recipients of the social intervention (to identify effectiveness). Second, contextual data, including general socio-economic conditions in households and communities and the levels and nature of general and specific social interventions, is required to develop appropriate controls for evaluation models. Third, robust and time-sensitive evaluations of policies, and/or aspects of policy innovation to more broadly inform implementation decisions, are needed (OECD, 2014f).

7.29 Some suggested steps to build this evidence base include:

- Broader social outcomes of each intervention should be defined, including expected spill-over effects.

- These social outcomes should be measurable independently of the policies' target measures, and include at least one distributional measure to retain a check on the 'inclusivity' of the intervention effect (see 7.4.2).

- Compulsory evaluations should be incorporated into the publicly funded interventions, publically incentivised forms of SII, or as part of formal regulation practices; and encouraged in independent forms of SII (this may require the development of a business case).

    - Evaluations need to be methodologically rigorous, and so support with the implementation of or methods for evaluations should be available as part of the development of a SII market, by sponsored independent researchers, or a formal regulatory body.

    - Timing of all social intervention evaluations should be predetermined and based on when social returns to interventions can be expected. More than one evaluation might be needed, as the same intervention may contribute to more than one outcome over time (see 7.4.3).

- Data techniques, such as data matching to administrative sources and national surveys, could be facilitated by governments and independent groups to provide access to contextual data in order to and improve the quality and efficiency of evaluation processes.

7.30 It is worth noting at this stage, that there is a trade-off between the need for timely policy interventions and the weight of - and wait for - the most rigorous evidence. Because it is important to act on social need in a timely way, there should be an expectation for 'learning on the job'. Risks associated with such an expectation can be limited first and foremost by piloting social interventions, by undertaking independent evaluations on untested aspects of the intervention, and preparing a recipient-focussed (pilot) 'exit plan' with appropriate funding in place (OECD, 2014f).

7.4.1 Evaluating cost effectiveness or cost-benefit ratios?

7.31 Many governments may not have capacity and systems in place to measure cost-effectiveness of public service delivery, however, social impact investment can present a strategic opportunity for initiating the collection of such data. Clearly, these types of approaches would need to build over time with a balance being found between effective measurement and effective market development.7.32 Two types of evaluation methods are potentially relevant for assessing SII interventions: cost-benefit analysis (CBA) and cost-effectiveness analysis (CEA) (see OECD 2014f for a more detailed discussion of these methods). Cost-benefit analysis (CBA) enables evaluators to compare the costs of a policy or intervention with its benefits measured in monetary terms (even if the benefits themselves are not pecuniary). Cost effectiveness analysis (CEA) compares the costs of meeting a given policy objective by alternative means.

7.33 The distinction is important. In the case of CBA, accurate information on the costs of meeting the objective must be available. Secondly, and most importantly, the program benefits must be *valued* even if they are not market goods (i.e. do not have a *price)*. By expressing costs and benefits in the same units, CBA is used to indicate whether a given policy objective is desirable When used on its' own CEA cannot help the policymaker decide what the policy objective should be since the benefits and costs are not expressed in the same units. This also means that it is impossible to compare across different policy domains. As such it cannot be used to determine whether the policy is welfare-improving in the strict sense. Rather CEA is used to determine the costs of meeting a given objective, and to compare between the costs of meeting that given objective through alternative means.

7.34 In the context of policy discussions related to SII the role of CBA is limited for a number of reasons. First, social impact investors and investees may have objectives related to social needs which are distinct from (and in many cases be more ambitious than) stated policy objectives. Second, the investor and the investee derive a value from the investment which may or nor may not be identical to that which is appropriate for the evaluation of public policy.[36]

7.35 The role of CEA in policy discussions about SII is more obvious. For instance, CEA can be applied to evaluate healthcare policies, for which it can be difficult to assess the monetary benefits but it is relatively straightforward to determine the desired outcome (e.g. "number of lives saved" or "DALYs" [EuropeAid, 2005]). CEA measures costs in monetary terms and compares them with the outcomes, expressed in terms of relevant units which related to the social need in question. The ratio of costs to effectiveness is computed in order to determine the cost per unit of effectiveness; the most effective projects will have lower cost-effectiveness ratios than alternatives.

7.36 This methodology is directly relevant for the case of SII. Firstly, investors and investees may well be interested in knowing whether or not their investments are meeting their objectives in terms of social needs at least cost. Secondly, policymakers would be interested in knowing whether different policy measures which incentivise the development of SII may be a more efficient way to meet their policy objective than more traditional state-managed forms of service delivery.

7.37 The evaluation should be as comprehensive as possible in the determination of costs and benefits, accounting for indirect and long-term effects of the program and reflecting the interests of all stakeholders involved (Better Evaluation, 2014a and 2014b). Interventions with social savings expectations and social outcomes expectation can undertake both forms of evaluations.

7.4.2. Measuring social impact: selecting social outcome measures

7.38 Any type of social intervention is designed to achieve a social goal, SII is not different. The importance of measuring social outcomes was highlighted by the SIITF as well as by the Working Group on Impact Measurement (WGIM, 2014). The social outcomes defined by a social intervention should meet some standards, including: being predefined, measureable, valid, repeatable, and independent (not distortable). Social outcome monitoring may also include the addition of spillover measures, or time-sensitive changes to the social outcomes desired.

36 . For example in the case of CBA it is important to draw a distinction between paternalistic and non-paternalistic altruism, and it is only the former which is relevant when ascertaining whether or not a policy intervention is welfare-improving. See Johansson (1992) for a discussion.

- **Predefined:** Social impact investment should predefine its purpose, this allows for the intervention to be assessed on a common goal for all aspects of process and implementation. It allows other social impact investments to run complementary to it, and set expectations for social impact investors in the case of SII.
- **Measurable**: Alone, whether an outcome is measurable is not enough to justify its selection, it also needs to accurately operationalise the predicted social outcome (see below). However, this is important because some aspects of a social intervention might be hard to measure (e.g. the preferences for care for dementia sufferers, or early year's children in childcare) and selecting unmeasurable outcomes will ultimately devalue future evaluations and bring into question the real impact. Whether monetised, (as may be required for SIBs), quality of life based (reduction in poverty) risk reducing (reduction in criminality) or efficiency enhancing (reductions in emergency service use) outcomes indicators should be – proxies or otherwise – the predefined outcome should be measureable.
- **Valid:** A valid outcome measure accurately represents the desired outcomes, and is particularly important in the case of proxy measures for hard-to-measure outcomes. Inappropriate responses to social needs could occur if social enterprises focus their efforts on invalid representations of desired outcomes. Depending on the population being evaluated, and the type of outcomes being measures (particularly survey responses) outcomes measures may need to be validated during pilots to ensure they are not biased by gender, age or culture of the recipients – or generate biased non-response to evaluation requests.
- **Repeatable:** In the case of multiple evaluations on the same measure, to determine outcomes or cost-effectiveness relative to a time frame, outcome measures need to be repeatable – insofar as they should be measured accurately more than once over a period of time (ensuring previous surveys or evaluations do not affect future measurement). For external validation of an intervention or its methods, or the transferability of an intervention, the measurement of the social outcome of interest should be repeatable in other settings.
- **Independent:** Target setting may create incentives for selecting in easy-to-treat individuals into a social service, achieving measureable change but unequally. This can restrictive the inclusivity of social impact investment, and create further social problems down the line. Any outcome measure linked to payment-related targets should be measurable independently of the policies' target measures in order to assess 'real change', and include at least one distributional measure to retain a check on the 'inclusivity' of the intervention effect.

7.39 In some policy settings, an intervention may be expected to have spillover effects in other sectors, both positive and negative. Additional indicators may be needed to monitor these spillover effects for the purposes of addressing the 'wrong pockets' problem (when returns to investment are found in other sectors), or adjusting a social impact score for SII based on negative externalities.

7.40 Finally, social impact investors and social delivery organisations should be prepared to adjust the outcome measures used to evaluate an intervention based on the time since the intervention occurred – these might be termed 'accumulated outcomes' and valued accordingly. The Perry Preschool intervention, mentioned in Chapter 5, is a working example of this, where early years' interventions were still having positive social impacts decades later, but in the labour market and educational outcomes, as oppose to early years' outcomes of child health and parenting skills development. Equally, spillover outcomes may also be subject to this principal.

7.41 Another example is the recent evaluation of the first Social Impact Bond (SIB) that launched in 2010 as a new approach to address recidivism in the UK (see Chapter 3 for further background). The Peterborough SIB, developed and launched by Social Finance (SIB intermediary), provides pre- and postrelease help to around 2000 short-term prisoners aiming to reduce re-offending rates (by at least 7.5%) by the end of the pilot scheme. If the pilots are successful, outcome payments can reach USD 12.2 million from a total USD 7.6 investment. If social outcome thresholds are not met, investors will lose their cash. The initial results of the evaluation of the Peterborough SIB have recently been released and are described in Box 7.1 below.

Box 7.1. First Peterborough SIB outcome results

On August, 2014 the U.K. Ministry of Justice (MoJ) released the first results of the Peterborough SIB programme. This evaluation focuses on the outcome results of the SIB designed to meet pre-determined targets in terms of re-conviction rates.

The Government alongside the Big Lottery Fund (SIB commissioners) agreed to pay investors back their capital plus a return on their investment if there was an improvement of re-offending rates. These payments may reflect a proportion of the savings to the Government and wider benefits to the society that result from interventions by non-government delivery organisations and investors.

The measurement of the Peterborough SIB outcomes is designed around two cohorts of adult male offenders discharged from Peterborough prison. The first cohort includes individuals released between 9 September 2010 and 1 July 2012 after serving sentences of less than one year. The second cohort opened in July 2012

The Peterborough SIB foresees that investors receive an outcome-based payment if one of the following scenarios materializes:

1) *A reduction of 10% in the frequency of re-conviction events in each cohort of around 1 000 prisoners (from the baseline generated by a matched comparison group);*
2) *A reduction in re-conviction events of 7.5% or more detected across all 2 000 offenders in both cohorts, when measured against a matched comparison group.*

The 10% and 7.5% thresholds were calculated, based on sample sizes and historical data, to ensure that any observed differences in re-offending rates between matched samples would be statistically significant. A statistically significant difference implies that outcomes payments are made for changes as a result of the SIB intervention and not due to unrelated factors.

The results of the first Peterborough cohort show a 8.4% reduction in terms of frequency of re-conviction events. This is below the required 10% reduction under condition 1) above, thus no payment is made to investors. However, the outcome result is above the 7.5% threshold under condition 2) above. Therefore, should the second cohort yield similar results, investors will be paid an agreed fixed sum per reduced re-conviction event.

Propensity Score Matching was used to calculate the percentage reduction in reoffending rates resulting from the Peterborough SIB approach. The cohort of 936 discharged offenders from Peterborough was matched against a national control group control group of 9 360 matched re-offenders discharged from other 34 male local prisons during the same period. The pre-matching samples included 31 207 observations from other prisons and 945 for Peterborough. The matching was done based 36 out of 38 demographic and criminal history variables such as offender age, ethnicity, nationality, number of past convictions or type of offence. The analysis was done based on detailed individual data provided by the MoJ and further information made available by Social Finance (the Peterborough SIB intermediary). Jolliffe and Hedderman (2014) provide further details on the data and methodological approach used.

Source: MoJ (2014) and Jolliffe and Hedderman (2014).

7.42 The preliminary results of the SIB model show that it has been successful thus far, both in terms of attracting funding to address social needs, as well as in effectively tackling social issues. However, there are a number of challenges and risks that should be taken into consideration when designing and implementing a SIB or other SII models including incentives and risks of unintended consequences, spillovers and cross-sector gains, and measurement risks.

7.43 In areas that involve complex and expensive social issues, no single SIB commissioner can justify making all of the outcomes payments. In the UK, the Social Outcomes Fund was created to address challenges related to spillovers and cross-sector gains — i.e. the returns on the provision of social services can accrue in distinct social areas. This fund leverages the contribution of outcomes-based commissions such as SIBs.

7.4.3. Methodologies and challenges for evaluating outcomes

7.44 Once an outcome, or set of outcomes, has been identified as a desirable result of social impact investment the next challenge for assessing impact of an SII-backed intervention is designing an appropriate evaluation.

7.45 Below is a checklist of questions to take into consideration:

- **What aspects to evaluate:** Clarify whether the intervention as a whole or aspects of the intervention are to be evaluated. Adjust or developing appropriate outcome indicators and controls accordingly.
- **Who to evaluate:** Recipients of the interventions, control groups, and extended populations (e.g. families of recidivists, communities, the general population) depending on the nature of the target population and expected spillovers.
- **When to evaluate:** Depending on the intervention (childcare vs. elderly care for instance), the expected outcome (e.g. long-term life outcomes for childcare, shorter periods for service take-up goals?), and should be timetabled in advance of the intervention (as part of the SII business plan).
- **How to evaluate:** consider piloting in the first instance, and identifying suitable control groups for control trials (for details of this method see chapter 3 of OECD, 2014g), in absence of this tailored survey data pre, during and post interventions, or pre-existing surveys might allow for difference-in-difference tests. For expectation of long-term returns, longitudinal cohort data may be useful. Cost benefit analysis should be included as standard, as should contextual description of governance and implementation practice for the purposes of transferability.

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ANNEX 7.1. EXAMPLES OF POLICY INSTRUMENTS IN G7 COUNTRIES AND AUSTRALIA

Country	Name	Type	Link
AUS	Social Enterprise Development and Investment Funds (SEDIF)	Supply	http://employment.gov.au/social-enterprise-development-and-investment-funds
CAN	RISQ Fund (Quebec)	Supply	http://www.fonds-risq.qc.ca/
CAN	Fiducie du Chantier de l'économie sociale (Quebec)	Supply	http://fiducieduchantier.qc.ca/?lang=eng
CAN	SVX trading platform (Ontario)	Intermediaries	http://www.svx.ca/
CAN	Social Enterprise Demonstration Fund (Ontario)	Supply	https://www.ontario.ca/business-and-economy/social-enterprise-demonstration-fund
CAN	Toronto's Centre for Social Innovation	Demand	http://socialinnovation.ca/
CAN	Community Contribution Companies (C3, British Columbia)	Tax & Regulation	http://www.fin.gov.bc.ca/prs/ccc/
CAN	Community Interest Companies (CIC , Nova Scotia)	Tax & Regulation	http://nslegislature.ca/legc/bills/61st_4th/1st_read/b153.htm
CAN	Social Innovation Fund (Alberta)	Supply	http://humanservices.alberta.ca/social-innovation-fund.html
CAN	Immigrant Access Fund	Supply	http://www.iafcanada.org/
Europe	EUSEF	Tax & Regulation	See Box 3.5
Europe	Social impact accelerator	Supply	http://www.eif.org/what_we_do/equity/sia/index.htm
FRA	LOI n° 2014-856 : Économie Sociale et Solidaire	Tax & Regulation	http://www.legifrance.gouv.fr/affichTexte.do?cidTexte=JORFTEXT000029313296&categorieLien=id
FRA	BPI France planning to provide funding	Supply	www.bpifrance.fr/Vivez-Bpifrance/Actualites/Economie-sociale-et-solidaire-decouvrez-le-rapport-d-etape-de-Bpifrance-sur-le-financement-de-l-ESS
ITA	Legge delega di riforma del Terzo Settore	Tax & Regulation	http://www.governo.it/Governo/ConsiglioMinistri/dettaglio.asp?d=76205
ITA	Specific social cooperatives legislation	Tax & Regulation	(in certain regions only)
ITA	Bank foundation legislation	Tax & Regulation	
ITA	Normativa sul Microcredito	Tax & Regulation	http://microcreditoitalia.org/index.php?option=com_content&view=article&id=335&Itemid=353&lang=it
ITA	L'Ente Nazionale per il Microcredito	Other	http://microcreditoitalia.org/index.php?lang=it
ITA	Titoli di Solidarietà (D.Lgs n. 460/1997)	Tax & Regulation	http://www.normattiva.it/uri-res/N2Ls?urn:nir:stato:decreto.legislativo:1997;460
JAP	Legal amendment to the corporate law	Tax & Regulation	
JAP	New Public Commons	Other	http://www5.cao.go.jp/npc/index-e/index-e.html
JAP	Social Innovation Forum	Demand	http://japan-social-innovation-forum.net/
JAP	Osaka Prefectural Government's Social Entrepreneur Support Project	Supply	http://www.pref.osaka.lg.jp/chiikifukushi/kigyouka/syakaikigyoukafand.html
UK	Community Investment Tax Relief	Tax &	http://www.hmrc.gov.uk/specialist/citc_guidance.ht

		Regulation	m
UK	Futurebuilders	Supply	http://www.futurebuilders-england.org.uk/
UK	Community Interest Company (CIC)	Tax & Regulation	https://www.gov.uk/government/organisations/office-of-the-regulator-of-community-interest-companies
UK	Dormant Bank and Building Society Account Act	Tax & Regulation	https://www.gov.uk/government/publications/review-of-the-dormant-bank-and-building-society-accounts-act-2008
UK	Investment and Contract Readiness Fund (ICRF)	Demand	http://www.beinvestmentready.org.uk/about/
UK	Big Society Capital (BSC)	Intermediaries	http://www.bigsocietycapital.com/
UK	Social Outcomes Fund	Supply	http://blogs.cabinetoffice.gov.uk/socialimpactbonds/outcomes-fund/
UK	Commissioning Academy	Supply	https://www.gov.uk/the-commissioning-academy-information
UK	Social Value Act	Other	https://www.gov.uk/government/publications/public-services-social-value-act-2012-1-year-on
UK	Unit Cost Database	Other	http://data.gov.uk/sib_knowledge_box/toolkit
UK	Social Investment Tax Relief (SITR)	Tax & Regulation	http://www.hmrc.gov.uk/sitr/
US	Small Business Investment Company Impact Investment Fund	Supply	http://www.sba.gov/category/lender-navigation/sba-loan-programs/sbic-program/general-information/impact-investment-sbic
US	Program-Related Investments	Tax & Regulation	http://www.irs.gov/Charities-&-Non-Profits/Private-Foundations/Program-Related-Investments
US	Community Reinvestment Act	Other	http://www.federalreserve.gov/communitydev/cra_about.htm
US	Low-Income Housing Tax Credit	Tax & Regulation	http://portal.hud.gov/hudportal/HUD?src=/program_offices/comm_planning/affordablehousing/training/web/lihtc/basics
US	National Housing Trust Fund	Supply	http://nlihc.org/issues/nhtf
US	Riegle Community Development and Regulatory Improvement Act	Tax & Regulation	https://www.govtrack.us/congress/bills/103/hr3474
US	Community Development Financial Institutions Fund	Supply \ Demand	http://www.cdfifund.gov/
US	New Markets Tax Credit	Tax & Regulation	http://www.irs.gov/pub/irs-utl/atgnmtc.pdf

Note: Information on Germany is available (NAB_GER, 2014) but not yet in English and will be added once available. SIBs are considered as policy instruments but are not included in this table because they are exhaustively covered in Annex 3.1, Chapter 3. This table excludes policy instruments targeting areas or activity that does not fit within the OECD working definition presented in Chapter 4. The table only provides information on SII-specific policy instruments. Therefore, policy instruments that affect SII but do not necessarily target the SII ecosystem (e.g. seed funds; regulations on institutional investors asset allocation and risk) are excluded.

Source: OECD, based on National Advisory Board (NAB) reports — NAB_AUS (2014), NAB_CAN (2014), NAB_GER (2014), NAB_FRA (2014), NAB_ITA (2014), NAB_JAP (2014), NAB_UK (2014), NAB_US (2014).

8. CONCLUSIONS AND NEXT STEPS

8.1 As social needs continue to grow, social impact investment can open the door to greater innovation in the way that social issues are tackled and potentially provide new ways to more efficiently and effectively allocate public and private capital to address social and economic challenges at the global, national and local levels. While these innovative new approaches will not replace the core role of the public sector or the need for philanthropy, they can provide models for leveraging existing capital using market-based approaches with potential to have greater impact.

8.2 Interest and activity in social impact investment continues to develop around the world. There is a greater recognition of the need for effective solutions to social challenges drawing a growing and broader range of capital providers. Private sector investors, such as foundations, high net worth individuals and institutional investors are increasingly interested in making investments that can have both a social and a financial impact, which has implications for developed and developing countries.

8.3 The social impact investment market is at an important inflection point. Awareness, interest and activity have increased, in particular due to the international initiative launched under the U.K. G8 Presidency in 2013 and the subsequent work of the Social Impact Investment Taskforce and the National Advisory Boards. These initiatives are now moving into a new phase which will include expanding to the G20 countries and beyond.

8.4 This paper has attempted to provide frameworks and approaches for thinking definitions and data in the social impact investment market, highlighting the implications for policy. The paper seeks to deepen the discussions about the definitions of social impact investment to enable clearer comparisons within and across countries.

8.5 The social impact investment ecosystem framework outlined in the paper highlights the importance of starting with the social needs and beneficiaries, not with the financial instruments being applied. A mix of financing instruments can then be tailored to those particular needs and beneficiaries. As discussed in Chapter 5, the context within each county is a critical determinant for the possible opportunities for social impact investment.

8.6 Given the growing level of activity in the social impact investment market around the world, it is crucial to build the evidence base to understand what works and ensure that capital is put to work on interventions that achieve the intended impact. This includes systematically collecting data and being able to use the data in a cross-country comparable way to better track the development of the market.

8.7 In particular, further work is needed to assess the role of SII in developing countries. This report has focused on the G7 and Australia. Further work could expand the scope to the G20 countries and beyond. Changes in the development finance landscape will require new measures to capture the full spectrum of financial instruments and facilitate the analysis of funding from all sources. The shift in sources of financial flows will also require further analysis of the trade-offs in terms of various types of financing, including SII, as well as a scoping in terms of which market settings are more appropriate for various types of financing. This could build upon current OECD work on financing for development.

8.8 There also needs to be deeper knowledge sharing about social impact 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, efficiencies and outcomes of particular practices. More detailed case studies which outline the roles of various actors and the processes involved in structuring social impact investment products would be useful along with more formal evaluations of these practices.

8.9 Social impact investment touches many different fields of analysis. To minimise the challenges of building a robust evidence base for the whole SII market, detailed analysis could initially focus on certain cases and\or social need areas. This more focused approach is important as there are bound to be variations in appropriate policies within and across sectors. As part of the next phase of the work on social impact investment, the OECD could, for example, focus on a particular area and work on building the evidence base across difference countries and cases.

8.10 At this stage of development of the SII market, an international organisation, such as the OECD, could potentially play a useful role in facilitating shared definitions, common data collection processes, development of indicators and evaluation of policies, in addition to providing a platform for the review and sharing of information about policies and practices.

8.11 The social impact investment market remains small relative to traditional markets, however, it is growing in visibility and importance. Further and sustainable growth would require a commitment to building the evidence base in terms of practices and outcomes.

GLOSSARY

Angel Investors

An angel investor is an individual investor (qualified as defined by some national regulations) that invests directly (or through their personal holding) their own money predominantly in seed or start-up companies with no family relationships. Angel investors make their own (final) investment decisions and are financially independent, *i.e*. a possible total loss of their investments will not significantly change the economic situation of their assets. Angel investors invest with a medium to long term set time-frame and are ready to provide, on top of their individual investment, follow-up strategic support to entrepreneurs from investment to exit. (OECD, 2012)

Asset Lock

The Asset Lock is a restriction on the transfer of assets. Asset Lock is designed to ensure that the assets of companies (including any profits or other surpluses generated by its activities) are used for the benefit of the community. (adapted from BIS, 2013)

Catalytic (first-loss) capital

Catalytic (first-loss) capital (CFLC) entails a capital provider that will bear first losses (the amount of loss covered is typically set and agreed upon upfront). By improving the recipient's risk-return profile, CFLC catalyses the participation of investors that otherwise would not have participated. CFLC aims to channel commercial capital towards the achievement of certain social and/or environmental outcomes. In addition, the purpose can also be to demonstrate the commercial viability of investing into a new market. CFLC is a tool that can be incorporated into a capital structure via a range of financial instruments. (authors based on GIIN, 2013)

Community investing

Community investing refers to the provision of financial services to underserved communities and includes banks, credit unions, loan funds, and venture capital funds. (Freireich and Fulton 2009)

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)

Cost-Benefit Analysis (CBA)

Cost-benefit analysis is a technique used to compare the total costs of a programme/project with its benefits, using a common metric (most commonly monetary units). This enables the calculation of the net cost or benefit associated with the programme. (Better Evaluation, 2014a)

Cost-Efficiency Analysis (CEA)

Cost-effectiveness analysis is an alternative to cost-benefit analysis (CBA). The technique compares the relative costs to the outcomes (effects) of two or more courses of action. (Better Evaluation, 2014b)

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)

Market failure

Market failure is a general term describing situations in which market outcomes are not Pareto efficient. Market failures provide a rationale for government intervention. (OECD Glossary of Statistical Terms)

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)

Non-profit institutions (NPI)

Non-profit institutions are legal or social entities created for the purpose of producing goods and services whose status does not permit them to be a source of income, profit, or other financial gain for the units that establish, control or finance them. In practice their productive activities are bound to generate either surpluses or deficits but any surpluses they happen to make cannot be appropriated by other institutional units. (UN, 1993)

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)

Sample size

The number of sampling units which are to be included in the sample. In the case of a multi-stage sample this number refers to the number of units at the final stage in the sampling. (OECD Glossary of Statistical Terms)

Sample survey

A sample survey is a survey which is carried out using a sampling method, i.e. in which a portion only, and not the whole population is surveyed. (OECD Glossary of Statistical Terms)

Services, social

Social (and collective) services provide final consumption for households and are distinctive for their non-market character in most OECD countries. Collective consumption decisions and public financing are common, as is production by governments, non-profit organisations and subsidised private organisations. Social services comprise the following International Standard Industrial Classification (ISIC) Rev. 3 sub-groups:

- government proper (civil or military);
- health services;
- educational services;
- miscellaneous social services.

(OECD Glossary of Statistical Terms)

Social benefits

Social benefits are current transfers received by households intended to provide for the needs that arise from certain events or circumstances, for example, sickness, unemployment, retirement, housing, education or family circumstances. (OECD Glossary of Statistical Terms)

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 context

Social context refers to variables that, while not usually the direct target of policy, are crucial for understanding the context within which social policy is developed. (OECD Glossary of Statistical Terms)

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 expenditure

Social expenditure is the provision by public (and private) institutions of benefits to, and financial contributions targeted at, households and individuals in order to provide support during circumstances which adversely affect their welfare, provided that the provision of the benefits and financial contributions constitutes neither a direct payment for a particular good or service nor an individual contract or transfer. Such benefits can be cash transfers, or can be the direct ("in-kind") provision of goods and services. (OECD Glossary of Statistical Terms)

Social Impact Bond (SIB)

A Social Impact Bond is a financial mechanism in which investors pay for a set of interventions to improve a social outcome that is of social and/or financial interest to a government commissioner. If the social outcome improves, the government commissioner repays the investors for their initial investment plus a return for the financial risks they took. If the social outcomes are not achieved, the investors stand to lose their investment. (Social Finance website)[37]

Social Impact Investment (SII)

Investments made into businesses and social sector organisations, directly or through funds, with the intention of generating a measurable, beneficial social and environmental impact alongside a financial return. (SIITF, 2014a)

Social Impact Investment is a transaction between an investor and investee in a social area, targeting beneficiaries in need. Beneficiaries targeted should be at risk populations and the good provided should have a mix of public and private good characteristics. These transactions are often made using intermediaries. The investee in the transaction should, at least, inscribe a compulsory reporting clause of its social activity in the statutes, as well as provide a formal evaluation of social impact. In parallel, the investor should, at least, have a compulsory reporting clause for social impact investments and have return expectations above or equal to zero, but not above the market rate of return (actual return may be higher). (OECD working definition, 2014)

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)

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).

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)

37. Available at: http://www.socialfinance.org.uk/services/social-impact-bonds/.

Target Population

The set of elements about which information is wanted and estimates are required. Practical considerations may dictate that some units are excluded (e.g., institutionalized individuals, the homeless, or those that are not possible to access without incurring excessive cost). (OECD Glossary of Statistical Terms)

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).

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ANNEX A. OECD EXPERT MEETINGS: LIST OF PARTICIPANTS

Paris 21 March 2014 and London 18 June 2014

Ms. Rosemary ADDIS	Executive Director Impact Strategist Co-founder Impact Investing	Australia
Mr. Jake BENFORD	Senior Project Manager Bertelsmann Foundation	Germany
Ms Sandy BLACKBURN-WRIGHT	Executive Director Impact Strategist Co-founder Impact Investing Australia	Australia
Mr. Amit BOURI	Managing Director Global Impact Investing Network	United States
Mr. Kieron BOYLE	Head of Social Investment and Finance UK Cabinet Office	United Kingdom
Dr. Stephen BRIEN	Chair's Executive Team Social Impact Investment Taskforce	United Kingdom
Mr. Adrian BROWN	Principal Boston Consulting Group	United Kingdom
Professor Mario CALDERINI	Department of Management, Economics and Industrial Engineering Politecnico di Milano	Italy
Ms. Radana CRHOVA	Senior Economist Office for Civil Society, Government Innovation Group UK Cabinet Office	United Kingdom
Ms. Aimie COLE	Chair's Executive Team Social Impact Investment Taskforce	United Kingdom
Ms. Carolien DE BRUIN	Specialist Leader Monitor Institute	United States
Mr. François DE WITT	President FINANSOL	France
Ms. Sarah DOYLE	Senior Policy Advisor MaRS Centre for Impact Investing	Canada
Mr. Guilhem DUPUY	Attaché de Direction Générale ECOFI Investissements	France
Dr. Danilo Giovanni FESTA	General Director Ministry of Labour and Social Policy	Italy
Ms. Stephanie GIAMPORCARO	Senior Lecturer Bertha Centre for Social Innovation and Entrepreneurship, Graduate School of Business University of Cape Town	South Africa
Mr. Gunnar GLÄNZEL	Senior Researcher Centre for Social Investment, Heidelberg University	Germany
Ms. Paula GOLDMAN	Senior Director, Knowledge & Advocacy Omidyar Network	United States
Dr. Riccardo GRAZIANO	Director General National Microcredit Agency	Italy
Dr. Siobhan HARTY	Director General, Social Policy Employment and Social Development Canada	Canada
Dr. Lisa HEHENBERGER	Research Director European Venture Philanthropy Association	EU

Ms. Diana HOLLMANN	Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH	Germany
Mr. Richard JOHNSON	Chairman, BIAC Technology Committee CEO Global Helix LLC	United States
Mr. Nigel KERSHAW	CEO Chairman, The Big Issue Ltd Big Issue Invest	United Kingdom
Professor Mario LA TORRE	Professor of Banking and Finance Department of Management - Banking and Finance University of Rome " La Sapienza"	Italy
Ms. Alexandra MEAGHER	Policy Advisor Social Investment and Finance team UK Cabinet Office	United Kingdom
Ms. Jane NEWMAN	International Director Social Finance UK	United Kingdom
Professor Alex NICHOLLS	Professor of Social Entrepreneurship Said Business School, Oxford University	United Kingdom
Mr. Nick O'DONOHOE	Chief Executive Officer Big Society Capital	United Kingdom
Ms. Stephanie PETRICK	Director Social Investment Impact in Motion	Germany
Mr. Karl RICHTER	CEO and Co-founder Engaged Investment - EngagedX	United Kingdom
Mr. Matt ROBINSON	Director of Strategy & Market Development Big Society Capital	United Kingdom
Ms. Yasemin SALTUK	Executive Director of Research J P Morgan	United Kingdom
M. Hugues SIBILLE	Vice-Président Présidence Groupe Crédit Coopératif	France
Ms. Julie SUNDERLAND	PRI Program Director Bill & Melinda Gates Foundation	United States
Ms. Louise SWISTEK	Investment Manager Le Comptoir de l'Innovation	France
Dr. Volker THEN	Managing Director Centre for Social Investment University of Heidelberg	Germany
Ms. Marilou VAN GOLSTEIN BROUWERS	Managing Director Triodos Investment Management BV	Netherlands
Mme Nadia VOISIN	Conseillère soutien au secteur privé dans les pays en développement Direction Générale de la Mondialisation et des Partenariats Ministère des Affaires Etrangères Sous-Direction de la Sécurité Alimentaire et du Développement humain	France
Mr. Arthur WOOD	Founding Partner Total Impact Advisors	Switzerland

The New York Times | http://nyti.ms/1ypqDvP

The Opinion Pages | OP-ED COLUMNIST

How to Leave a Mark

JAN. 27, 2015

David Brooks

The big debate during the 20th century was about the relationship between the market and the state. Both those institutions are now tarnished. The market is prone to devastating crashes and seems to be producing widening inequality. Government is gridlocked, sclerotic or captured by special interests. Government is an ever more rigid and ineffective tool to address market failures.

So over the past generation many of the most talented people on earth have tried to transform capitalism itself, to use the market to solve social problems. These are people with opposable minds: part profit-oriented and part purpose-oriented. They've created organizations that look a little like a business, a little like a social-service provider, and a little like a charity — or some mixture of the three.

Hippie companies like Ben & Jerry's ice cream led the first wave in this sector, but now you've got a burgeoning array of social-capitalist tools to address problems — ranging from B Corporations like Warby Parker (which gives free glasses to the poor) to social impact bonds. (For example, a private investor raises money to finance a program to reduce recidivism. If the program works and the government saves money because there are fewer prisoners to house, then the government pays back the investor, with a profit.)

Impact investing is probably the most promising of these tools. Impact investing is not socially responsible investing. Socially responsible investing means avoiding certain companies, like tobacco growers. Impact investors seek out companies that are intentionally designed both to make a profit and provide a measurable and accountable social good. Impact funds are frequently willing to accept lower financial returns for the sake of doing good — say a 7 percent annual return compared with an 11 percent return. But some impact investors are seeking to deliver market-rate returns.

Brian Trelstad of Bridges Ventures, has looked at companies in early autism intervention, paid for by Medicaid, that can improve long-term educational outcomes while reducing spending on special education; affordable after-school enrichment programs that bring extra education services to charter school students; and energy efficiency companies that serve people in public housing, which saves long term heating costs.

When impact funds came on the scene, seven or so years ago, there was the usual overhyping. A 2010 report by the Rockefeller Foundation and JPMorgan projected that impact investing could see new capital inflows of up to $1 trillion by 2020. That's looking unlikely given that right now roughly something like only $40 billion has been invested through these funds.

There are more roadblocks than anticipated. It's hard to find a reliable way to measure the social impact of these dual-purpose companies. Impact investors have also had trouble finding scalable deals to invest in. It costs as much to do due diligence on a $250 million deal as on a $25 million deal, so many firms would rather skip the small stuff.

The hype created skepticism and a backlash. But impact investing is now entering the mainstream. An older generation used their (rigorous) business mind in one setting and then their (often sloppy) charity mind in another. Today more people want to blend these minds. Typically a big client, or a young heir, will go to his or her investments adviser and say, "I want some socially useful investments in my portfolio." If the adviser has nothing on offer, the client leaves the firm.

New impact funds are being born. In a low-interest-rate era, they can offer comparable returns. The Obama administration has been aggressively supportive. Social stock exchanges are being founded. The big players like Goldman Sachs and Credit Suisse are now in the field.

I recently sat in a beautiful New York meeting room with a nicely and formally dressed banker, Andy Sieg, as he discussed the impact fund he's helping to create at Merrill Lynch. He said his associates, especially his young associates, were extremely eager to work on the project. People are eager to have this kind of impact.

Impact investing is not going to replace government or be a panacea, but it's one of a number of new tools to address social problems. If you want to leave a mark on the world but are unsure of how to do it, I'd say take a look. If you're a high-net-worth individual (a rich person), ask your adviser to get you involved. If you're young and searching, get some finance and operational skills and then find a way to get involved in a socially useful investment proposition. If you've got a business mind, there are huge opportunities to build the infrastructure (creating measuring systems, connecting investors with deals).

Someday government will get unstuck, with new programs to address this new era. But there's no prospect of that happening soon. Right now social capitalism is a more creative and dynamic place to spend a life.

A version of this op-ed appears in print on January 27, 2015, on page A21 of the New York edition with the headline: How to Leave a Mark.

BARRON'S

Penta Daily

Insights and advice for families with assets of $5 million or more.

March 6, 2015, 2:14 P.M. ET

How Impact Philanthropy is Shape-Shifting

By Robert Milburn

A study by Exponent Philanthropy suggests philanthropists and family foundations are becoming more impact-oriented, doling out fewer grants but with larger dollar amounts given to only the top-performing nonprofits.

Exponent Philanthropy estimates that it's 2,300 members, with total assets of $87.8 billion, made 158,000 grants last year, down from 203,000 a year earlier. But the median grant size increased 24% to $19,116.

That's a significant refocusing of business, says Exponent Philanthropy CEO Henry Berman. These foundations have stopped blankly writing checks, jettisoned underperforming charities, and are now zeroing in on nonprofits that truly matter to the family's overall mission.

But add up the aforementioned grant-making numbers and another truth emerges: Charitable giving actually declined by 3.5%, as the foundations gave away 6.5% of their assets. This, while the average foundation endowment realized 14% returns, versus the previous survey's increase of 9.7%.

So charitable giving declined while the value of portfolios grew. What gives? Exponent Philanthropy thinks it has the answer. Its poll asked 777 member foundations to identify “the most important issues facing foundations.” The top three big concerns were board/generational succession, need for greater focus/impact in grant-making, and family/board dynamics.

Issues of succession have opened up a broader dialogue between the current generation and heirs, says Berman, and, in order to engage their children ages 18 to 30 years old, they are asking for input. That’s an important change. “This is a restless generation that is more willing to take risk,” Berman says. And that translates into fewer but more targeted grants that might have significant impact in the world.

This move on the grant-making side dovetails with impact-investing, the other major trend shaking up the old philanthropic order. (For more, see Penta stories ”Social-Impact Investments Finally Grow Up” and ”Social-Impact Investing is on the Rise“) Philanthropists are using their foundation’s endowments to make strategic for-profit investments in their area of interest, in effect leveraging the foundation’s portfolio off of the family’s core mission.

Exponent found that 13% of the foundations they surveyed are engaged in some form of socially-responsible investing. This practice is about effectively putting to work the other 93.5% of assets not sent out to charities in grants last year, in a way that aligns with a foundation’s greater objectives. “A foundation looking for a cure for cancer shouldn’t be buying tobacco stocks [in its endowment portfolio],” Berman says, illustrating the sort of passive screening that has been around for decades. But this new breed of players is being more proactive, perhaps channeling, in this particular case, venture capital funds to biotech firms working on a new breed of cancer drugs.

Private bankers concede this approach generally resonates most with millennial investors, but it’s quickly gaining street cred with others. The foundations that are currently doing some form of impact investing have boldly invested 41% of their overall portfolio in this way. Exponent Philanthropy hasn’t been tracking the trend long enough to know how that number has grown in, say, the past 10 years, but Berman insists “a lot of folks are talking about it.”

Our advice: Watch that 41% number. If this new breed of early adopters doubles down, as investment results trickle in, it will be a strong sign of pioneering success, to the watchful eyes of other foundations. If that happens, this nascent space will quickly ratchet up to a tipping point, and the foundation executives currently dabbling in impact investing for the pleasant cocktail chatter boast, will quickly switch to making it a significant piece of their portfolio and a key part of their mission.

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The Metrics Myth

February 10, 2015

Why Quantitative Presentation of Qualitative Value Matters

Since at least the early '90s, those involved in the generation of more than money have been on a quest to capture the right balance between documentation of impact and claims to same. For me personally, I have been a reluctant crusader in this quest for coming on thirty years. As a social worker in San Francisco's Tenderloin District, operating a multi-service center for homeless youth, justification of our funding was often tied to service counts. And yet, while our program served large numbers of youth, we often found financial support for those youth tied to annualized government contracts and lump sum foundation grants directed to other programs for these funds did not follow performance, but were allocated on the basis of what I called a dance of deceit set to the music of politics, perception and persuasion.

Some years later, as founding director of the nation's second venture philanthropy fund, I led the team that in 2000[1] introduced what I believe was the first formalized methodology to track SROI—Social Return on Investment. Prior to that, I remember hearing foundation and social investors alike state, "We invest for Social Returns!" Yet when queried as to how, exactly, they tracked such returns they would laugh, saying, "Oh, no! It's a metaphor—we don't actually *track* social returns!"

I never did understand this.

A traditional investor would never place funds in a venture that did not have capacity to track financial performance and, ultimately, financial return. How then was it okay to place funds in social enterprises (whether for-profit or non-profit) in the absence of reporting systems tracking the extra-financial value creation of that investment? Why bother calling ourselves social entrepreneurs and impact investors if we could not in some way document, differentiate and assess this added level of value creation?

Over past years, as I've both participated in and observed the evolution of metrics and impact reporting discussions and practice, I've come to realize the "metrics challenge" is something of a myth. It is a myth in both senses of the term in that on the one hand it is the Big Foot of impact investing—widely known yet seldom seen—and, on the other hand, pursuit of the next level of "metrics" is the Holy Grail of our professional quest, a story that has critical meaning, value and importance in our lives.

Big Foot Counts

At its core, the metrics discussion is a myth because while everyone talks about it, professes to have seen it and debates its importance, impact metrics remain ephemeral, a force living in some deep wood, visions of which are obscured by branches, brush and bullshit. At a national metrics conference several years ago, I recall a breakout session presentation by one of the world's best known impact investment organizations—one that appears on everyone's list of favorite impact funds—listening to a nuanced and well-considered presentation by their head of impact performance. Following the formal PowerPoint show that included impressive definitions, charts and data, the presenter was asked, "How do these impact metrics inform your work?" to which the presenter responded, "Oh—we don't actually *use* these metrics in our work. We just need them to give our funders!" After everyone had a good laugh, he said, "No, no—I'm serious—we don't use them at all!" Peals of continued laughter echoed…

While I was taken aback by how forthright this practitioner was in his assessment of the relevance of metrics to practice (or lack thereof!), I also experienced something of a flashback to my time as a social worker wherein metrics mattered not as a means to more effective program or service delivery, but rather simply as a way to justify continued funding to those removed from the action. Why, I thought, would someone possibly spend their entire professional life involved in work the value of which could only be assessed on the basis of people served rather than lives changed? Couldn't we create a metrics framework truly capable of capturing not only outputs in order to justify funding, but also assess the deeper outcomes of our efforts as well?

More recently, as various new impact funds have been conceived and launched, it has become clear, despite the old adage "You can't manage what you don't measure," many impact fund managers do just that. While we all talk about the difference between traditional and impact investing as a function of our tracking the extra-financial performance of social and environmental value creation, too many social entrepreneurs and impact fund managers view metrics and performance tracking as "something we do for funders" rather than something we need do for ourselves to ensure our work is actually creating the impact we seek rather than the outcomes we claim.

And I believe it is getting worse…

In recent weeks, I've heard of two leading fund managers—overseeing hundreds of millions of dollars of supposed "impact" capital—who have said that since they are investing in sectors that have intrinsic impact, their funds (investing in sustainable agriculture or renewable energy or affordable housing or small business development or what have you…), by extension, do not need to document or be managed explicitly for impact. Now, perhaps I've been in these discussions for too many years and have grown both cynical and short-tempered, but how is this any different from nonprofit managers who are working to affect change in communities or in people's lives asking us to trust them since, after all, "We're all here for the children"?

As our greatly revered 40th President of the United States used to say, "Trust—but verify!" and I think impact investors should do the same. Social entrepreneurs or impact fund managers who claim to have impact in the absence of documentation tied to their execution should be challenged. If they have the continued arrogance to state that their special fund has impact simply by virtue of their strategic intent, they should be tarred and feathered and shunned, for we should not confuse intent with impact. As one of my good colleagues once observed, "You could be creating the best and greatest 'next generation' battery for the electric car, but if your rare earth metals are being strip mined, you are not advancing a more sustainable planet."

Period.

All too often, I fear, we do indeed confuse our noble intent with actual, realized and demonstrated impact. They are not the same.

Metrics matter.

The challenge, of course, is that actually creating meaningful, relevant social management information systems to track the total performance of our impact investments takes more time and money than many social entrepreneurs and investors care to spend. In some perverse variation of the "We don't fund overhead, only program" comment one sometimes hears from foundation executives and donors, too many of those in the impact investing community view an effective metrics reporting system as "nice to have" as opposed to "critical to our practice in advancing impact." And therefore, while the topic of metrics continues to carry much weight in our conversations—a "must have" topic at any impact investing conference and justification for any number of stand alone meetings, events and professional junkets—the reality is for far too many of us involved in impact investing actually *attaining* sustained metrics practice is, in truth, frequently seen as the dreamlike, mythical Loch Ness Monster, with flashing skin and scales so close you can almost touch them as it twists and turns and slowly descends out of sight, into the muddy murk of our investing waters.

In Quest of the Holy Grail

And yet, the myth persists that we can attain our goal of effective and relevant metrics assessment and reporting. One must ask, after all the frustration and challenges, why do we bother? I submit we persist in our pursuit because we know at a deeply visceral level our goal of integrating meaningful metrics into the core of our efforts to create a changed world has value and is central to who we are.

When asked,

"Do you believe in a god?"

C.G. Jung replied,

"I do not believe there is a god—I *know* there is a God."

And so here, my good and patient friend, is the fundamental point:

Our commitment to attaining the Holy Grail of credible, sound impact reporting is less a function of faith than of stripping our current intellectual and practical shrouds away to reveal the deeper essence of what we know to be true.

Simply because our present, dominant approaches to assessing metrics fall short of our task—How can one measure the full value of a life saved or possible future changed? What, ultimately, is the real impact and value created through the allocation of our capital?—we persist because we know two things:

First, we know we are on a Hero's Journey of inquiry and innovation. Too often we forget the present system of tracking financial performance (the basis upon which trillions of dollars flow through global capital markets and the foundation upon which too many of us build our lives) is the outcome of over sixty years of development, refinement and debate. In the U.S., GAAP and FASB (the fundamental building blocks of mainstream business and finance) were not created until after World War II; and it was not until the creation of the Environmental Protection Agency in 1970 that business and many nonprofits began tracking and assessing environmental metrics on a consistent basis. And while social metrics have always been a part of the parlance of government and philanthropic funding, many foundations and social investors have not sought to weave performance assessment into their process of allocating funds until recent decades. It is for these reasons I am quite comfortable with the reality that those creating the metrics and evaluation frameworks of tomorrow will need another twenty years to build what is not yet ours, for I know it will come in good time.

Second, we are creating Total Portfolio Reporting frameworks to track the returns of unified investing strategies (capable of reflecting the aggregate performance of philanthropic, social and environmental value creation) because we *know* it can be done—and indeed, we see the metrics mist clearing by the year.

As initiatives such as

The Principles for Responsible Investing's Integrated Reporting work,

the recently re-organized SROI Network,

the Sustainable Accounting Standards Board,

B-Lab's B-Analytics framework,

CapRock's iPar system,

the ANDE Metrics Working Group

and a variety of grassroots initiatives coming together around various sets of common reporting for assessing community impact,we find one *can* create a balance between our aspirations for a better world and the challenges of demarcating our progress toward that goal.

In the end, I hate the whole metrics debate.

It is repetitive, mind numbing and distracting from the critical task of fighting the forces presently destroying our societies and planet. Each time some ignorant (not stupid, mind you, and yet, not fully aware of what they do not know; they are quite rightly, ignorant) newcomer enters the discussion, we're all expected to re-group and re-define concepts and issues well documented and explored in the past. The continual, mindless reminders that not everything that counts can be counted leave me frustrated and even angry at some who for reasons beyond me don't seem to understand that such now trite insights were the very starting place of this journey well more than 25 years ago and that, indeed, as newcomers they are as far behind the current exploration as we are from our goal.

Yet, we make progress despite our doubts and complications.

We advance the practice of both impact investing and performance measurement one step forward and two steps back as the current "knowledge" of the crowd actually pulls us backward to previous thinking and practice. And we know the appropriate application of metrics bring meaning and insight just as they demonstrate the limitations of such efforts. This journey is critical to us not simply because it holds the promise we may, in time, create effective tools to better represent the quantitative performance of qualitative value, but rather because in more deeply being a part of this journey toward documenting the impact of our strategies, we see new and more nuanced aspects of the value we seek to create through the course of our lives…

We learn more about who we are as individuals and as a community.

And so I say,

Onward, compatriots, onward!

There is another windmill over yonder hill—

and we will make our own path by walking toward it!

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[1] Our original framework was presented in 1996 in the Roberts Foundation report, *New Social Entrepreneurs: The Success, Challenge and Lessons of Nonprofit Enterprise Creation*, but we did not present the full complement of a framework and related tools until our Box Set publication in 2000.

Posted in Blog, Impact Investing, Metrics, Social Return On Investment, Sustainable Finance

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