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Blended Value Investment and the Lessons Learned from Development Studies

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Abstract: Aid and development has to a large extent failed to generate long-term economic growth in large part of the developing world in the post-war era. This has generated a lot of theory and literature about different solutions, frequently involving “smarter” aid. This study applies named development theories to the emerging field of Blended Value Investment (or Impact Investment) in order to generate new impact themes and hypothesis. It uses the performance metrics for social impact utilized by firms and organization to define what the current impact themes of blended value investors are. In the comparison between the impact themes derived from social performance metrics and the development goals generated by the study of aid new themes emerge. Development theory is used in the study to define *what should be measured*, while the empirical material defines *what is measured* and the conclusion of the study is the gap in between, *what could be measured by blended value investors*. The conclusion recommends new measurement themes like contribution to middle-class building, financial market development and image improvement.

Keywords: blended value, impact investing, development, entrepreneurship, poverty, social performance metrics

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Contents

| | |
|--|----|
| 1 Background..... | 3 |
| 1.1 Research Question | 3 |
| 1.2 Contribution | 4 |
| 1.3 Justification..... | 4 |
| 1.4 Challenges | 5 |
| 1.5 Terminology..... | 6 |
| 1.6 Scope and limitations | 6 |
| 2 Methodology | 8 |
| 2.1 Metrics as object of study | 8 |
| 2.2 Theoretical Approach | 8 |
| 2.3 Empirical Approach | 9 |
| 2.4 Quality of data | 10 |
| 3 The Concept of Blended Value | 12 |
| 3.1 Creating a coherent discipline | 13 |
| 3.2 Standardization and Language | 13 |
| 3.3 Towards a market-oriented approach | 14 |
| 3.4 Behavioral Finance | 15 |
| 4 Theoretical Framework | 16 |
| 4.1 Market Exclusion | 17 |
| 4.2 Image Problems..... | 18 |
| 4.3 The Middle Class Consensus..... | 19 |
| 4.4 Financial Markets and Internal Trade | 20 |
| 5 Social Metrics | 21 |
| 5.1 Examples of methods and metrics | 21 |
| 5.2 Metrics Analysis Systems..... | 25 |
| 5.3 Impact Themes | 25 |
| 5.4 The “No metrics”-Approach | 28 |
| 6 Analysis: Specific Problems Identified by Development Studies..... | 30 |
| 6.1 Market Exclusion | 30 |
| 6.2 Image Problems..... | 31 |
| 6.3 The Middle Class Consensus..... | 32 |
| 6.4 Financial Markets and Internal Trade | 32 |
| 7 Analysis: Underlying Issues..... | 34 |
| 7.1 The Incentives of Philanthropy and Blended Value Investment | 34 |
| 7.2 The Macro/Micro Conflict | 36 |
| 7.3 The Scale of Impact of Philanthropy versus Blended Value Investments | 38 |
| 8 Summary..... | 40 |
| 8.1 Suggestions for further research..... | 41 |
| 8.2 Concluding notes | 42 |
| 8.3 Credits for interviews, emails and advice..... | 42 |
| 9 References | 43 |

1 Background

Traditional investments are measured solely by the financial value they create. In practice, the same investment simultaneously creates a number of other values; these can be both social and environmental in nature. Social value that can be created by investment include both pure economic gains such as job creation in disadvantaged communities or other more abstract gains such as human capital or self-confidence, while environmental dividends includes any improvements in things like pollution. The solutions to social and environmental problems are often expected to come from philanthropy, while the expectations on businesses rarely go beyond avoiding negative social and environmental impact. Blended Value Investing or Impact Investing are names for a breed of investments that intends to generate financial, social and environmental returns simultaneously, and hence blurs the line between philanthropy and business. The main challenge of the field is to measure these non-financial dividends in a satisfactory manner, and while the measurement of financial dividends, both past and future, has been developed in the course of centuries, the measurement of social dividends of investments is still in its infancy¹.

The need for market-based approaches to development in general, and blended value investment in particular, can be partly attributed to the fact that in the post-war period, aid has been largely unsuccessful in generating long-term economic development.

1.1 Research Question

This study aims to analyze methods and metrics used by blended value investors in order to assess what kind of social impact is commonly measured by investors, and compare these to the goals defined in literature about aid and development. Development literature has a longer history and therefore has accumulated more experience on the challenge of development, and therefore has developed definitions of aims and problems to a larger degree than practitioners and scholars of blended value investment. *Therefore the study aims to compare whether the measurements of blended value investors are aligned to solving problems that development studies define.* The primary research question is hence:

“What problems, identified by development studies, are addressed by blended value investment?”

In order to answer this question we need to know first of all: *1) What are the problems identified by development studies?* This in essence means explanations to why poverty prevails in parts of the developing world; examples include corruption, resource dependency and historical legacies such as colonialism. A lot of literature about these problems is derived from the failure of aid to address the issue of long-term economic growth, and the solution presented is often more effective aid, but this study uses only the definition of the problems and instead investigates possible solutions from blended value investment.

¹ Tuan, 2008, Page 18

Secondly, to answer the research question we need to know 2) *How do blended value investors measure their impact?* This includes proxies used and what their immediate impact goals are. Common examples here include job creation, human capital formation and improved health which are often measures of success in terms of social impact. These metrics are often used to measure the achievement of specific social goals pertaining to an organization, but this study intends widen the scope to investigate what their effect on the larger goals defined by development studies are.

The primary research question is hence a comparison between what development studies defines “*should be done?*”, compared to “*what is done?*” by blended value investors, and the answer to the research question will therefore be “*what could be done?*”. These questions are all answered in turn in the theoretical, empirical and analysis chapters, as described by the research structure for the study:

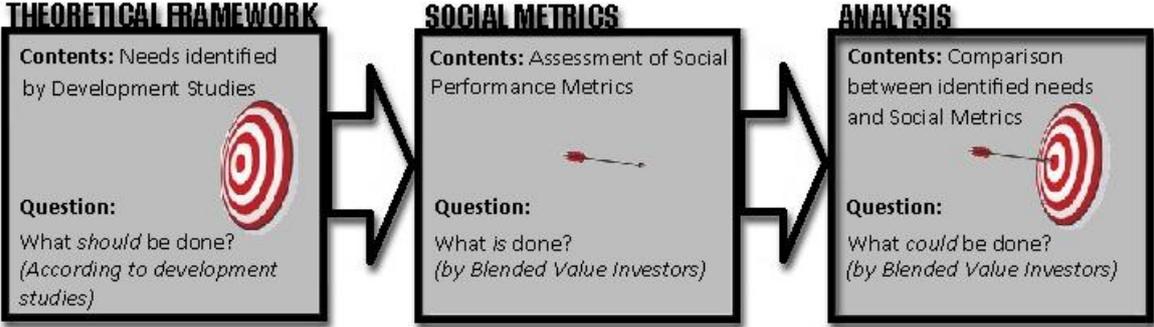


Figure 1, Research Structure

1.2 Contribution

This study intends to contribute to the improvement of the social impact of blended value investments, either through improvements of social performance metrics or an understanding of the social impact itself. In the gap between the needs defined by development studies and the social impact measured by blended value investors, there is expected to appear impact themes, needs to be fulfilled, previously unexplored by blended value investors. This could include positive social impact that is previously unknown or unspoken. It could also reveal contradictions where short-term positive social impact leads to negative social impact in the long run. The main intention is hence to find new impact themes or contradictions between commonly measured impact themes, rather than specific new social performance metrics. Hence the end result will rather be hypothesis regarding the efficiency of social impact of investment, some of them that could potentially be quantitatively tested.

1.3 Justification

The reason for the prevalence of global poverty are basically a series of market failures, were a large section of the world’s population are not included in the global markets. Aid has been attempting to correct these market failures, and in terms of long-term development has been largely unsuccessful². Blended value investment is a promising new way of development which harnesses the market forces creating win-win situations for both investor and investees in developing countries or disadvantaged communities.

² Moyo, 2009
4

Bridging Business and Philanthropy

Blended value investment is at the junction of two separate trends, one of increased demand for more effective philanthropy³, where donors are growing increasingly demanding in terms of proof of actual impact not merely output figures. Simultaneously, the CSR and Socially Responsible Investing movements have been growing indicating an increasing interest for social issue from the business world. Since the body of knowledge of blended value is growing in a space between business practitioners and philanthropy practitioners, there is a need to develop a common terminology⁴ to increase the understandability and terminology enough for traditional investors to consider social value when investing for financial goals.

The very notion of mixing philanthropy and business is often counter-intuitive for practitioners and academics on both fields, and there is a cultural difference that manifests itself in different terminology and approach. In the business community a prevalent attitude has often been “the business of business is business”⁵, and even CSR has often been seen as an expense related to PR rather than part of the value-creating process. Similarly, non-profit organizations in many cases are bound by rules against making a profit, or merely frown at the notion, even if having an opportunity of doing so at great impact. The greatest difference is that raising funds from investors and donors requires radically different approach and changes the incentives for the organization. The lesson to be learned in both fields from blended value is that economy is not a zero-sum game, that it is not a matter of trade-off; one can potentially have both types of dividends simultaneously. This is a radical departure in philosophy for both development workers and business people accustomed to thinking of profit and philanthropy as mutually exclusive.

1.4 Challenges

Studying a subject in its infancy is a challenge for several reasons. For one it is very much in constant change and new studies were published in the course of this study. Another challenge is due to the newness of it is to communicate how it differs from other related fields, as a subject like this can at first glance easily be dismissed into merely pertaining to an existing field, such as CSR or charity, rather than a field in its own right.

Complexity of subject

Large amounts of business strategy literature proves that generating financial value is a complicated task, and considering blended value makes management decisions even more complex. With all the same considerations as a profit-focused business, the social and environmental concerns add a lot of variables to the equation. Where traditionally costs simply has been a matter of minimizing, taking blended value into account means that some of the costs can actually serve towards fulfilling goals, sometimes with trade-off for minimizing and sometimes not. This makes not only the equation complex but also requires a change of mindset where not all cost cuts or revenue increases are goal-fulfilling.

Therefore, the idea of measuring social impact in a way that is comparable between sectors is

³ Godeke & Pomares, 2009, page 124

⁴ Emerson, 2003, page 14

⁵ The origin of the quote is disputed, often attributed to Milton Friedman in his *Capitalism and Freedom* (1962)

sometimes seen as insurmountable. The argument is that there are too many assumptions involved and that different social values cannot be sufficiently compared. How do you compare the value of one improvement of quality of life like improved income to an improvement in health? These are valid questions but that scholars of the field believe will be solved.

Compared to financial accounting one can see that even there, the bottom line does not tell the whole story of the quality of a business either but that the actual quality depends on a large number of other factors. When taking investment decisions, especially venture-capital type investment the bottom line is complemented by a number of ratios and indicators like solidity, and likely qualitative factors and perceived quality of the entrepreneur. The system of accounting with result sheet and balance sheet has furthermore been under development for centuries, while calculating the social impact has barely one decade since its inception, depending on definitions.

1.5 Terminology

The term Impact Investing was coined at the formation of the Global Impact Investment Network in the fall of 2009, and basically denotes investments which “...aim to solve social or environmental challenges while generating financial profit⁶”. On the other hand, blended value investment, coined by Jed Emerson⁷, is used in similar ways but is a broader term related to the simultaneous creation of social, financial and environmental values, and he draws the difference in that Impact Investment is the method, while blended value is the goal⁸.

In practice, given the small difference in definition, one of the terms will likely be the dominant in the future discourse on the field, and at the time of the writing of this thesis choosing one is a bit of a gamble. In spite of the term “Blended Value” being first, the term “Impact Investing” seems to be gaining momentum in the media⁹, however, the term “Blended Value” is more linguistically flexible, used as a verb when “blending value” and can also be used with economic concepts other than investing such as “Blended Value Accounting” and will hence be used extensively in this study. Other variations include social returns, and bottom- or triple bottom line accounting¹⁰ to express a company with multiple goals; the term does not capture the fact that the different values are inseparable and will not be used in this study.

1.6 Scope and limitations

Focus on Long-term economic development

While there are large amounts of social problems needing to be solved, this study takes the perspective that far from all problems can be addressed with a market-approach like blended value investment. In this study a lot of comparison is made with aid and development, partly because of the failure of aid to generate long-term development, and therefore the field intends to some extent to replace aid in areas where it has not been effective. However, there are other types of aid which cannot be replaced;

⁶ www.globalimpactinvestingnetwork.org

⁷ Emerson, “Blended Value Map”, 2003

⁸ Source: Email from Jed Emerson

⁹ In the Wall Street Journal Report: “Social Finance and Philanthropy”, March 1, 2010, the terms “Impact Investing” and “Philanthrocapitalism” are used.

¹⁰ Elkington, 2004

disaster relief is one prominent example. In this study, the focus is not on temporary alleviating suffering but on the long-term economic growth on the national level.

Focus On Developing Countries

A lot of studies and practical applications on the field and have been done in the area of community development¹¹, a term often used in the US for domestic social investing in disadvantaged geographical areas. This study will focus more on the impact of investments in developing countries, as the needs, impact and metrics are all assumed to be different in a developing country as opposed to disadvantaged communities in developed countries.

Exclusion of Environmental Values

Blended value frequently includes environmental values created such as carbon offset or pollution reduction. This study will focus solely on the *social* impact in terms of quality of life since the environmental factors are more of a technical field. The third value to be blended together with social and environmental values is of course financial values, these will not be discussed specifically in this paper since there is plenty of research going on in that area.

Institutional prerequisites

This is an important factor of all economic growth, and no less so when addressing poverty and developing countries. In this study sound institutions will be considered a hygiene factor for blended value investments to work, and will not be discussed in detail.

Type of Investment

Blended value investments can take many different forms, like bonds, loan guarantees or debt obligations. While some of the metrics and principles discussed in this thesis might be applicable for a lot of these investment vehicles the thesis will take the perspective the investor, often venture capitalist. Similarly on the investee side, a lot of blended value investment could be public-private partnerships and infrastructure development, and while the metrics and principles might be related across a large number of fields the main perspective will be local entrepreneur as recipients of investment.

¹¹ Emerson, “The Blended Value Proposition”, 2003

2 Methodology

This chapter describes how the study is going to be performed. The study is defined as a qualitative study with data drawn from documents and interviews, all for the purpose of assessing how social impact is presently measured. The theoretical approach is explained as using the problems defined by development studies rather than the solutions they present, since solutions frequently are related to aid. The section explaining the empirical approach describes how metrics presently used by investors is going to be assessed. Finally follows a discussion on the quality issues of the data presented.

2.1 Metrics as object of study

Since the research questions of the study are based upon how things are done in practice and how they can be improved, the empirical basis for the study are the performance metrics being used by firms and organizations. These metrics vary widely in terms of formalization, from rigorous mathematical models to much more subjective, almost intuitive approaches. There are also firms frowning upon metrics in general and instead relying on organizational culture to assure desired impact. Therefore this subject, especially since methodology is the object of study, is best studied with qualitative methods. The aim of the study is not to draw quantitative conclusions as to the prevalence of various metrics but rather to find representatives from different approaches. A study of metrics is practically a study of common practices, or at least how these practices are expressed. This implies that the aim of the empirical material is not to find an absolute truth but rather to define common mental constructs and measure these with theory. In addition, the study of metrics pose challenges to data collection, due to the varying degree of formalization between actors in the market, ranges from a highly formalized IFC, a division of the World Bank, to 2-man firms. The sources of the more formalized metrics are secondary data in documents and descriptions of metrics, sometimes acquired for the study and sometimes publically available. To take into account the more informal aspects these documents have been complemented by primary data in the form of interviews. As a mixed method study, with a largely pragmatic¹² research philosophy it does not apply the hypothesis-proving deductive¹³ method but rather looks at the empirical material first, namely the performance metrics, and create theory from that. Yet it's not a pure inductive method as pre-existing theories are also used to trace what effects the metrics actually measure. This method could be described as a middle way, and abductive¹⁴ approach were the theory affects the data collected, resulting in a circular analytical approach were the starting point is mainly in the empirical material but the theoretical foundation is concurrently taken into account.

2.2 Theoretical Approach

The theoretical framework of this thesis consists of literature from the field of development. This literature has been used as a source of problem definitions, as there has been considerable effort put into theorizing about the reasons for the prevalence of poverty. The solutions in the literature often lie in development aid, but in this thesis it is the problems defined that have been used, with solutions instead drawn from the blended value field.

¹² Saunders, Lewis, Thornhill, 2009, page 119

¹³ Saunders, Lewis, Thornhill, 2009, page 125

¹⁴ Alvesson & Sköldböck, 2008 - From Källman, 2009

2.3 Empirical Approach

The empirical material in this study consists of metrics, procedures or qualitative descriptions of goals and philosophies of various blended value investors. The data hence varies significantly in terms of formalization, ranging from complete formal and published systems to individual assessments. Basically there is a simple question tree needing to be answered through the empirical material, mostly through official documents and were lacking, interviews.

Do you use metrics for social impact?

If yes, which ones?

If no, how do you fulfill your social mission?

Note that these are not interview or survey questions or anything of the kind, but rather the thematic questions that needed to be answered and in fact a lot of them could be answered through their public communication.

Data Collection

For this study a mix of primary and secondary data has been used, as both academics and practitioners vary in the formalization of their methods of evaluating the investment projects. For the most formalized structures, documents, both publically available and supplied particularly to the study has been used. For the more informal methods, primary data in the form of interviews has been collected, even in the case of rather formalized metrics the nature of investment activities require a lot of qualitative reasoning and must depend on “judgment rather than framework”¹⁵. The main body of data hence consists of documents, with interviews taking a complementary role. This is largely due to the fact that the empirical material consists of metrics, and when formalized these are more readily communicated through documentation.

Data Sources

Companies, foundations and organizations included in this study all have, at least in part some kind of blended value investment activities. It is important to note the theory will be drawn from grant-giving philanthropy but in terms of empirical material none has been collected since they are well-studied areas with plenty of theory to back them up, unlike the middle ground of blended value investment. To some extent, the study is a comparative study between blended value investment versus charity and traditional investment. In the companies and organizations included in the data are hence both companies investing for rates on par with the market and a clear simultaneous social agenda, and impact-first investors investing mainly for social gains while simultaneously making a profit, often at concessionary rates.

Documents

Most of the answers for the investigative three questions “*Do you use metrics for social impact?*”, “*If yes, which ones?*” and “*If no, how do you fulfill your social mission?*” are answered by the means of secondary data. For donor-funded ventures, transparency is a very important issue to assure donors that the money given is being used for good purposes. This causes the evaluation process to be rather open and often published in information channels towards the general public, such as web pages. This has been one source of secondary data for the study.

¹⁵ Interview: Pejman Altafi, Voxtra

If a venture leans towards the profit-first approach, less formalized data will be tends to be available, but due to considerations of competition, but also since they are investor-funded the incentives to provide large amounts of social impact data is not there, the potential cost for this is rather returned to the investors. In some of these cases, insights in the due diligence process have been given through various non-public documents like reports and slides for public presentations.

Interviews

Interviews were largely performed as a complement to the documents, filling the gaps that the documents did not cover, and should hence be viewed as secondary to the documents in terms of data. Interviews were done mainly by phone, with complimentary communication via e-mail, except in some cases where communication took place entirely by email. There was no interview structure, and questions were largely complementary to the publically available data by the organization in question. The goal was to have the three questions “*Do you use metrics for social impact?*”, “*If yes, which ones?*” and “*If no, how do you fulfill your social mission?*” answered one way or the other, and only when public material was unavailable, incomplete or too vague were interviews performed. For this reason the amount of interviewees was quite small and the extent of the communication with them varied greatly.

The level of the contact of the organization firm also varied greatly from founder/owner to employee, as could be expected when including entities of such different sizes. But the respondents were always part of the decision process of investment or consultants. The oral interviews were not recorded, mainly to make the respondents feel comfortable, and also because the need to word-for-word quotes is not so great, as the purpose of the interviews was to complement and explain the documents which will be the main source of reference.

2.4 Quality of data

The first quality issue here is validity, the question whether the empirical material measures what it is supposed to measure, and the second one is reliability, whether the data could be reproduced independent of context, in other words, the absence of biases and other data problems. The usage of performance metrics and systems of performance metrics as empirical material adds some additional issues with regards to quality, both positively and negatively.

Validity

Validity in the sense that the researched metrics corresponding to the metrics used in the field, has the inherent danger of being biased towards philanthropic ventures, as it is in the nature of donor-funded ventures to have more developed metrics as they depend on them for increased funding, and to be more forthcoming with these. Profit-first ventures would report less but not necessarily have less impact, and this makes the collection of metrics dominated by philanthropic ventures. Since the purpose of the empirical material is to collect the metrics used, this does not cause bias in the quantitative sense, but can lead to a lack in the collection of metrics from the profit-first side. These ventures often rely more on quantitative assessment rather than highly formalized methods, as there are no incentives from their investors to do so. The interviews are an attempt to mitigate this imbalance while bringing in the less formalized aspects of the profit-first actors into the empirical material which would otherwise be dominated by impact-first actors.

Another level of validity would be whether the metrics actually corresponds with reality, and there would basically be two categories of data problems in this area, metrics that are used but not reported, and metrics that are reported but not actually used. Metrics used but not reported would include some of the qualitative assessments sometimes based on tacit knowledge that would influence the investment decision, and these have been considered when performing interviews.

External Validity

External validity on the other hand, in the sense that the method is generalizable, is another issue which differs significantly when using metrics as empirical material. There is a risk; indeed it's likely, that not all available metrics are included. In this case though, if metrics used in the field have not been found in the course of the study they are probably so marginal that they still warrant the research and don't change the aim of the study which is to reveal new areas of possible impact. Furthermore, the study itself could suggest new metrics which would hence undermine the studies own external validity in a circular logic. External validity is normally defined to be generalizable for reality, and reality in this case is what actors do or say they do, and the study has no way or intention of differentiating between the two.

Bias and Reliability

This study doesn't intend to draw a representative sample of metrics but rather map out all the different kinds, and bias per se is hence not an issue. The empirical material does not regard whether a certain metrics is commonly used or unique to one particular organization. Bias could in a sense be an incomplete map and variables missing, but this would not render the study irrelevant unless the conclusion directly corresponds to existing undiscovered metrics or impact themes.

Research Errors

With the base of secondary data of documents and public communication material there is a small margin for error, especially among the more formalized metrics systems. Among the organization using a more informal evaluation system depending more on philosophy and qualitative assessments there is more interpretation involved and risk of research error larger. One of the potential hazards would be the very disparate languages utilized by philanthropic and profit-minded investors, this is a problem widely discussed in the field¹⁶ and since it's taken into consideration in this study the language issue has been kept in mind while taking organizational culture in mind when analyzing the data.

Another potential source of error in studies like this could be that the individual contacted in case of the interviews do not represent company policy. This hazard has been mitigated by controlling that the qualitative data fits into the organizational profile.

¹⁶Emerson, 2003, "The Blended Value Proposition"

3 The Concept of Blended Value

This chapter gives an overview of some of the literature written about blended value, divided into some of the main themes. These themes include the effort of creating a coherent discipline from many fields of study, partly through the creation of a common terminology. There is also comparison between philanthropy versus a market-oriented approach and behavioral finance explains some of the non-rational components of an investment decision which is particularly important when social values are taken into account in addition to financial ones.

The basic concept of blended value is that social, financial and environmental values are integrated and inseparable, and when intending to create one type of value, other types of value are inescapably produces simultaneously. This in itself is nothing new, but the addition of the blended value field is to acknowledge and measure these social and environmental dividends. The line between business and philanthropy can hence be blurred, maybe not so much in terms of intentions but definitely in terms of actual outcome.

In this study the concept of value is seen as a continuum moving from philanthropy with only social goals to traditional investment with only financial goals. In between these is the middle ground, and could be described as either “Impact-First Blended Value Investing” or ”Profit-First Blended Value Investing”, to various degrees. The continuum describes the *intention* of particular organizations, not necessary *outcomes*, since a social impact goal not necessarily implies concessions in terms of financial returns. The fundamental differences in approach at the 2 extremes is the *value transfer* of philanthropy and *value creation* of investor¹⁷

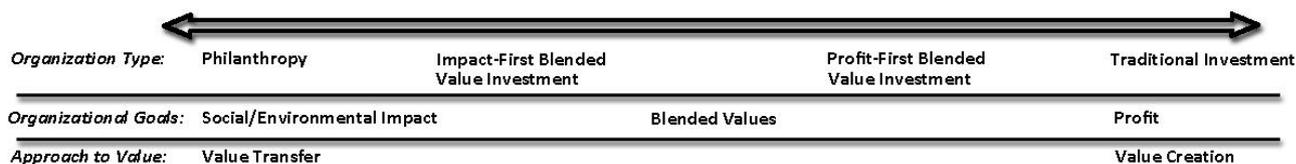


Figure 2, The Impact-Profit Intention Continuum, Based on “Spectrum of Practitioners by motive” (Emerson, 2005), Godeke and Pomares (2009) and World Economic Forum Report on Blended Value Investing (2006).

In academic journals the amount of articles concerning blended value or impact investing is not overwhelmingly large¹⁸; many of them are published by foundations¹⁹, and might therefore have an agenda beyond pure academic research. This could be a reason that there is still not a lot of theory- and hypothesis building in the field although both mentioned categories of papers do theorize and analyze the subject in addition to assessing the field. In general, which is likely a sign of the infancy of the field, papers tend to be riddled with suggestions for future research.

¹⁷ World Economic Forum Report, 2006, page 59

¹⁸ A search at Google Scholar for terms like ”Blended Value” and ”Impact Investing” yields a substantial amount of unrelated results.

¹⁹ Examples: World Economic Forum, Bill and Melinda Gates Foundation, Rockefeller Philanthropy Advisors, New Economics Foundation

The goal of a lot of the research is create a coherent discipline through the development of terminology and theory on the field.

3.1 Creating a coherent discipline

One of the most ambitious attempts to create a coherent field, creating a terminology, and defining the term blended value itself, is the “Blended Value Map”²⁰. Here 5 silos of research²¹ are described where similar things are studied and practiced, but since they come from different backgrounds such as business, philanthropy and academia, there is little communication between them. The 5 silos are: *Corporate Social Responsibility* – The social value intentionally created by for-profit business, ranging from donations to inclusion of social values in the value creation process.

Social Investment – Investment with social values in mind, investing in company believed to create social value. Negatively screened investment funds tend to call it *Socially Responsible Investment*, attempting to invest without doing any harm by excluding sectors like tobacco.

Strategic Philanthropy – This is philanthropy which is not viewed as merely giving but using investment philosophy and methods to create social dividends. In practice it is a form of charitable giving but the demands on measurable social impact is where it differs.

Social Enterprise – Ventures that to some degree has social value creation as its mission.

Sustainable Development – On the verge of not being a silo in its own right, since it in many ways overlaps with other silos. The silo describes initiatives and practices mainly in the business community, and predominantly dealing with environmental sustainability combined with economic growth.

These different silos all face similar challenges and needs but often employ different terminology. The main fault line drawn between the silos by Emerson is that *Social Enterprise* and *Corporate Social Responsibility* are largely based on the practitioner’s point-of-view while *strategic philanthropy* and *social investment* are based on the investor’s point-of-view, while *sustainable development* takes both perspectives. Another more common division in literature is the one between business practitioners and investors as opposed to philanthropy practitioners and investors²², two worlds were very different languages and approaches are used.

3.2 Standardization and Language

The different language and philosophy used by business practitioners and philanthropist is largely the challenge of the blended value field, as a common terminology is the foundation of the necessary trust between actors in the field. As of today, there are not enough commonly accepted metrics and frameworks for efficient communications and comparison between investors, financial intermediaries and investees²³.

A part from language the other challenge of the field is creating a standardized set of metrics²⁴, as

²⁰Emerson, 2003 “The Blended Value Map”

²¹Emerson, 2003 “The Blended Value Map”, page 8

²²World Economic Forum Report, page 63

²³Godeke & Pomares, 2009

²⁴Emerson & Bonini, 2005

today most social metrics are based on the specific vision of an organization or project. The problem is the challenge of comparing the value of very disparate social impact concepts, for instance crime reduction and water access. In the Double-Bottom Line Project²⁵ three kinds of methods are defined, process methods, impact methods and monetization methods. Process methods is basically measure output, something that traditionally has been sufficient for philanthropic ventures, donors being content with knowing for instance how much medical supplies have been delivered to a poor community. Impact methods on the other hand measure the next level, how many cases of disease have been avoided as a result of the medical supplies. Monetization methods thirdly would then be how big the socio-economic gain has been for society at large, calculated in monetary values, in our ongoing example. There is an ambition among some of the companies contacted in this study to measure their impact in monetary terms, although all would agree that there would always be intangible aspects that could be measured exactly. Looking at the past we can see that previously unthinkable values have been converted into monetary values, such as the use of trust between members of a community as a form of collateral substitute²⁶, like in the case of the famous Grameen Bank²⁷. Although Grameen Bank and microfinance institutions might not explicitly put a monetary value to this collateral substitute, the limits of borrowing for a particular group would make it possible to calculate this if there was a demand for it.

3.3 Towards a market-oriented approach

The concept of generating social returns without sacrificing financial return, doing well while doing good, is described by Godeke and Pomares²⁸ as “Genius of AND” (as opposed to “the Tyranny of OR”), borrowing terms from management studies²⁹. The idea is that apparent trade-offs don’t have to be trade-offs, like investment for the long-term does not have to mean sacrificing short-term performance. While this might raise question about the scarcity of resources, in the case of social impact and financial gain, the creation of financial values intrinsically can create social values, and frequently does, although this goes unmeasured. Therefore according to Godeke and Pomares the assumption that financial gain has to be sacrificed for social impact is false.

Two sectors derived from philanthropy that have been pioneering sectors, showing what is to come in terms of harnessing the “Genius of AND”, is low-cost housing³⁰ and microfinance³¹. A World Economic Forum report from 2006 presents a slew of case studies of blended value initiatives and many include commercial microfinance, likely since this is the most advanced and mature market with goals of blended value creation. A goal in the report is to develop micro finance securitization and creating a market for social impact bonds, in addition to the social impact value of these bonds they would be largely isolated from much of the business cycle³².

However, there is still a place for philanthropic contribution as first-movers, in sectors like microcredit and low-cost housing which have recently been commercialized, philanthropically intended

²⁵Clark, Rosenzweig, Long, Olsen, 2004, page 10

²⁶Balkenhol & Schütte, 2001, page 16

²⁷www.grameen-info.org

²⁸Godeke & Pomares, 2009, page 116

²⁹Collins & Porras, Build to Last, 1994

³⁰World Economic Forum Report, 2006, page 53

³¹World Economic Forum Report, 2006, page 7

³²World Economic Forum Report, 2006, page 18

investments have been valuable to create track records and develop efficient methods³³, since mainstream capital avoids sectors with a lot of unknown risks that are dominant in unexplored sectors.

3.4 Behavioral Finance

An important factor when understanding regular investment decisions, and possibly even more so when social impact is included in the equation, is the intrinsic irrational sides to human decision making. Godeke and Pomares attempt to combine this field, known as behavioral finance, to a social impact approach. Economic models often assume that people are rational and self-serving, but in practice investment decisions are affected by altruism, conservatism (ignoring new information), optimism and pessimism that are based on the past rather than the present situation and excessive reliance on stereotypes. The most important aspect of behavioral finance mentioned by Godeke and Pomares for the purposes of this study is the appearance of information asymmetries which can lead to “capital gaps in underserved urban and rural areas”³⁴, these gaps are fundamentally market failures where there could be profitable businesses but information about the area in the minds of the investors is tainted by information asymmetries.

³³ Godeke & Pomares 2009, page 47 and World Economic Forum Report, 2006, page 51

³⁴ Godeke & Pomares, 2009, page 47

4 Theoretical Framework

This chapter will describe research into why aid has proven insufficient to create long-term economic growth in the developing world, particularly Africa, and identify a number of specific issues that are stifling economic growth.

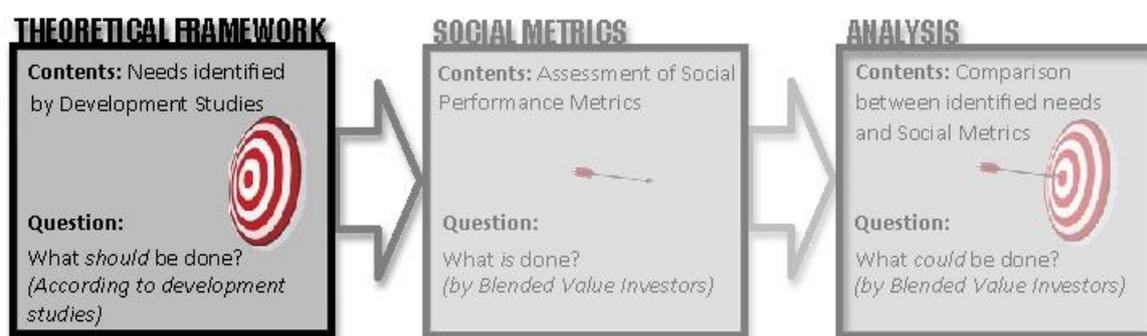


Figure 3, Research Structure - Focus on Theoretical Framework

The reasons for the prevalence of poverty are many, and this chapter will not be an exhaustive list of the theories. Excluded are theories where investment has little to do with the solution, such as ethnic diversity and institutional factors, or countries being landlocked, which are often pointed out as keys to economic failure. Those examples are important factors to understand the prevalence of poverty, but they fall outside of the scope of the study, since this study intends to juxtapose the needs identified by aid to the solutions provided by investment. Therefore only issues that could potentially be addressed with entrepreneurial investment are included, and even this list could be expanded.

Specific issues identified in this chapter are:

Market Exclusion – Large sections of the population is poor because they are excluded from the global markets, both as producers and consumers. If addressed by businesses both as customers and producers they have a fair chance to lift themselves out of poverty.

Image problems – Historical factors can cause the reputation of countries as investment recipients to be worse than reality, which hinders supply of capital. Likewise the same historical factors can cause a negative self-image in entire people groups, stifling long-term investment and entrepreneurial activity.

Internal market underdevelopment – The lack of trade between African countries exacerbates their aid dependency.

Financial market underdevelopment – Problem getting loans for budding entrepreneurs is one example of the limiting effect of an underdeveloped financial market.

Middle class building – Aid has tended to focus on the poorest-of-the-poor, but studies have shown that a strong middle class is conducive not only for economic growth but also political stability.

In many of these questions, the causality is an issue and sometimes these problems need to be solved on the political level in order for investment to increase. Nevertheless, poverty is generally a matter of vicious circles and investment with social motives can contribute to positive developments.

4.1 Market Exclusion

In his seminal book “The Fortune at the Bottom of the Pyramid”³⁵ Prahalad points out that it is not money transfers from rich to poor which truly empowers disadvantaged people but rather the inclusion of them in the markets. He defines the world’s poorest as savvy customers who due to their low income demand goods with the most value for very little money. His thesis is that by providing these goods, especially financial services, there is a source of revenue for international companies with large positive social implications. The growth of profitable micro-lending is an example of this in practice. By pointing out that the long-term solution for the poor is not to transfer funds to them like aid but rather by including them in the financial market where they can create their own value. In that sense global poverty is in essence one huge market failure, since in a market utopia with perfect competition there would be equilibrium through price-adjustment between countries and individuals.

According to other authors including Paul Collier³⁶ and Jeffrey Sachs³⁷ there is however an absolute bottom, whether counting individuals or countries that have too many institutional problems to be included in the market without development aid, dubbed “The Bottom Billion” by Collier. The problems that perpetuate poverty include among other things corruption, lack of infrastructure and protectionism according to Sachs, and civil strife, resource dependence and being landlocked among other things according to Collier. Both Sachs and Collier conclude that the solution to these long-term issues is smarter aid, more aimed at the poor one and in the right combination with institutional reform.

However, aid has by many accounts failed to create long-term economic growth during the last 60 years, and possibly exacerbated the problems. Dambisa Moyo in her book “Dead Aid”³⁸ concludes that in the case of Africa, aid has indeed hurt prospects for long-term growth since it actually undermines economic growth in warping the incentives for a healthy economy. One of these is that aid weakens the incentives for accountability of government towards their citizen, as a lot of funds come from abroad rather than taxpayers and governments priority become pleasing donors rather than taxpayers. Other negative effects of aid according to Moyo include inflation and corruption, all which in turn increases aid dependency in a vicious circle.

Combining these different views of global poverty, a revised version of Prahalad’s pyramid shows that in the bottom of the pyramid, there are a number of countries or individuals who are really outside of the scope of the market economy, as defined by Sachs and Collier. This group would not necessarily only include the poorest of the poor nations but could also include disabled, disaster victims or groups so isolated that they would not take part in a market economy. In the middle however, there is when adding the reasoning of Moyo a group that is at present dependent on aid, which should not have to be. These groups are not unable to take part in the market economy by some real factor but are rather victims of a market failure, such as *information asymmetries*³⁹.

³⁵ Prahalad, 2004

³⁶ Collier, 2007

³⁷ Sachs, 2005

³⁸ Moyo, 2009

³⁹ Godeke & Pomares, 2009, page 47



Figure 4, The Bottom of The Pyramid, Developed from Prahalad (2004)

What then is the solution for this market failure? Sachs and Collier both argue for “smarter aid”, but in different ways. Collier lists a couple of important institutional points such as trade policies and governance, and military interventions when needed, Sachs reasons along similar lines but argues that a different approach for each country is necessary, since the situation of each country is unique. Prahalad on the other hand promotes a market-driven approach, and to a large extent believes in Multinational Corporations in developing products that includes poor people in the market. Moyo on the other hand puts the solution in phasing out development aid all together, and that this will create incentives for leader to improve institutions and that economic growth will follow. In this thesis the focus will be the opportunities for blended value investors that can be created by these market failures⁴⁰, frequently information symmetries.

4.2 Image Problems

Much like a brand name of a product, the mere mention of a country or region conjures up particular images and emotions in the mind of potential investors that affect investment decisions. Future Brand has constructed a Country Brand Index measuring the strength of the brand name of nations, and according to them a strong brand name can “...promote economic value and export products; attract inbound investment, tourists and talent; redress stereotypes or clichés and build competitive advantage”⁴¹. For countries and regions that have been troubled by war, social unrest or disasters in recent history the challenge of re-building a negatively charged brand name, even if the situation is

⁴⁰ Godeke & Pomares, 2009, page 48

⁴¹ www.futurebrand.com

changing there will be a lag before the change is internalized in the brand. This is one of the problems of information symmetry previously mentioned that can cause market failures as defined by Godeke and Pomares. A negative image can express itself in ways, both in a negative self-image or inferiority complex, and as a negative image from outside the country.

As for problems with the outside image, Africa is a good example, while media image is not only negative; the positive images that exist in the west relate more to things like exotic wildlife than investment opportunity, and news reports normally only report famines and war, and the fact that most of the continent is fed and at peace most of the time is lost. Pineu⁴² writes: "Imagine if 9/11, the Oklahoma City bombing and school shootings were all that the rest of the world knew about America", as an example of the concurrent image of Africa in the west. Part of this problem is put on development practitioners, as they will increase their donations inflow by marketing misery, while showing the images of healthy hard-working businessmen that would be conducive to investment would likely have a negative impact on donations. Moyo, dubs charity initiatives like "Live Aid" as "glamour aid"⁴³ and claims that it perpetuates the image of Africans needing help and even being represented by rock stars like Bono rather than their own leaders.

As for the negative self-image, inferiority complex, Nobel laureate Wangari Maathai describe how a "cultural inferiority complex"⁴⁴ has appeared in Africa as a result of a history of colonialism and mission work where local culture and spirituality was suppressed leaving people "de-culturized" and not proud of their heritage and language. Economist George Ayittey also claims that the same inferiority complex is what can cause leaders to overcompensate and develop "megalomaniac obsessions"⁴⁵, with lavish spending on symbols of power like palaces. Maathai however also describes an inferiority complex on the community-level such and particularly among illiterates who are often acutely aware of their disadvantage, and this can be generalized to communities without particularly colonial history but just groups who for some reason have been at disadvantaged for a longer time, such as ethnic minorities or the low castes of India. Her solutions relate to re-connecting to pre-colonial institutions to develop a cultural sense of self, and this should happen through the political leadership⁴⁶. In this thesis however the focus will be not on the institutional or political prerequisites but on the impact of investment on this issue.

4.3 The Middle Class Consensus

When a society is polarized into groups of very rich and very poor, with few in between, economic growth tends to be seriously stifled. The very rich in these societies often fail to make the necessary investments into the human capital of the poor population in fear of losing influence, and at the same time the poor lack the resources to invest in their own human capital. On the other hand, a poor social class solely in power they tend to put a heavy tax-burden on the rich class, lessening the investment level of the rich further and cause a society which favors redistribution for consumption and less investment⁴⁷.

⁴² Pineau, 2006

⁴³ Moyo, 2009, page 26

⁴⁴ Maathai, 1995

⁴⁵ Ayittey, 1992, page 112

⁴⁶ www.african-times.eu "Why the continent needs a revolution in leadership" – By Wolf Lepenies

⁴⁷ Persson & Tabellini, 1994

The Middle Class Consensus means that a high share of income and therefore influence for the middle class of a country “facilitates higher levels of income and growth, as well as higher levels of public goods”⁴⁸, since a society that is not polarized tend to focus more on wealth creation than wealth redistribution and unite on matters like public goods. The Middle Class Consensus is also strongly dependent on ethnic diversity which tends to lessen benefits of a strong middle class.

4.4 Financial Markets and Internal Trade

Other commonly identified problem areas include lack of trade between poor countries, particularly in Africa, in North America internal trade is 40%, and in Europe 63%, while in Africa only 10%⁴⁹. The main reason behind this according to Moyo is punishing tariffs that African countries put on each other’s exports. Another problem is the underdevelopment of financial markets, which is a function of lacking creditor rights, contract enforcement, and accounting standards⁵⁰. These issues are institutional and political in nature and cannot be solved by investments; studies have shown that the impact of FDI alone on growth is ambiguous in the absence of well-developed financial markets⁵¹.

⁴⁸ Easterly, 2001

⁴⁹ Moyo, 2009

⁵⁰ Levine, Loayza, Beck, 1999

⁵¹ Alfaroa, Chandab, Kalemli-Ozcan and Sayek, 2004, Pages 89-112

5 Social Metrics

This chapter will begin by describing the methods and metrics for the measurement of the social impact for investment, providing the empirical foundation for this study. Firstly a few particular organizations and metrics systems will be described, and secondly various forms of metrics will be categorized. Finally in a key section the aims of the metrics will be assessed and categorized into different Impact Themes. These Impact Themes are crucial as it they that provide the comparison to the needs identified by development studies and answer the chapter question of “what is done?”.

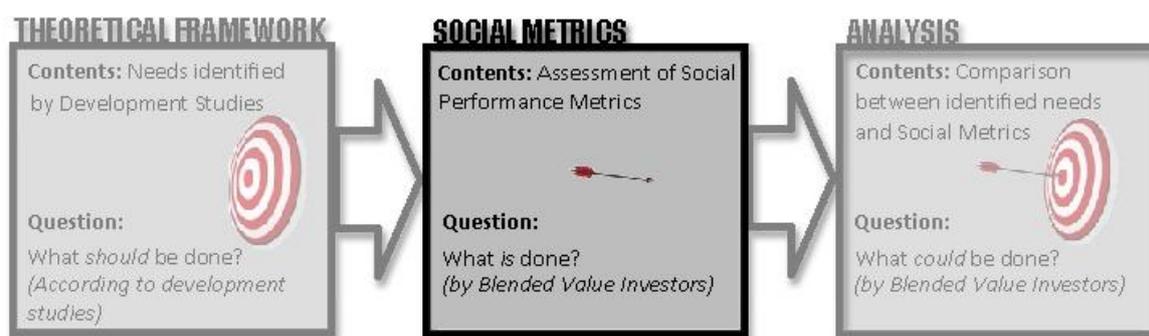


Figure 5 , Research Structure - Focus on Social Metrics

5.1 Examples of methods and metrics

Below is a description of the methodologies used by various firms and organization. They are not chosen because they are a representative sample but rather because they inhabit different parts of the impact-profit spectrum as they range from philanthropic ventures using market principles to profit investment firms with both social and financial goals. In this section, 4 has been mentioned specifically but more mentioned and more examined

Acumen Fund is a foundation, and works with impact-first investment where they take financial dividends into account in their investment decision, but the dividends are kept in the foundation and reinvested and not paid to investors, so the organization hence depends on donors. The method used for investment decision is the *Acumen Fund BACO ratio*⁵², BACO meaning “Best Available Charitable Option”. The BACO ratio is basically a cost/effectiveness analysis were the impact of an investment is compared to a counterfactual donation of the same amount and a comparison of which one is the most effective.

One example is the comparison of distributing free mosquito nets for malaria protection versus investing in a local factory to manufacture them. In this case the impact of the investment was compared to effect of a UNICEF project that distributed similar nets for free.

⁵² www.acumenfund.org, Tuan 2008, Appendix K

| Table 2: Social Impact Projections | | BACO | Acumen Fund investment |
|---|--|---------|------------------------|
| Comparable product cost | | \$3.50 | - |
| Total output | bed nets | 92,857 | 2,000,000 |
| Investor share of output ⁵ | | 100% | 20% |
| Investor output (enterprise efficiency) | bed nets | 92,857 | 400,000 |
| Impact factor | persons protected / bed net | 2 | 2 |
| Social impact [total output * impact factor =] | | 185,714 | 800,000 |
| Bottom Of Pyramid (BOP) Penetration ⁹ | % customers in BOP | 100% | 50% |
| BOP impact [social impact * BOP Penetration =] | | 185,714 | 400,000 |
| Product efficacy (technology leverage) | # of effective years of malaria protection | 2.5 | 5 |
| Total social impact [BOP impact * product efficacy =] | person years of malaria protection | 464,286 | 2,000,000 |

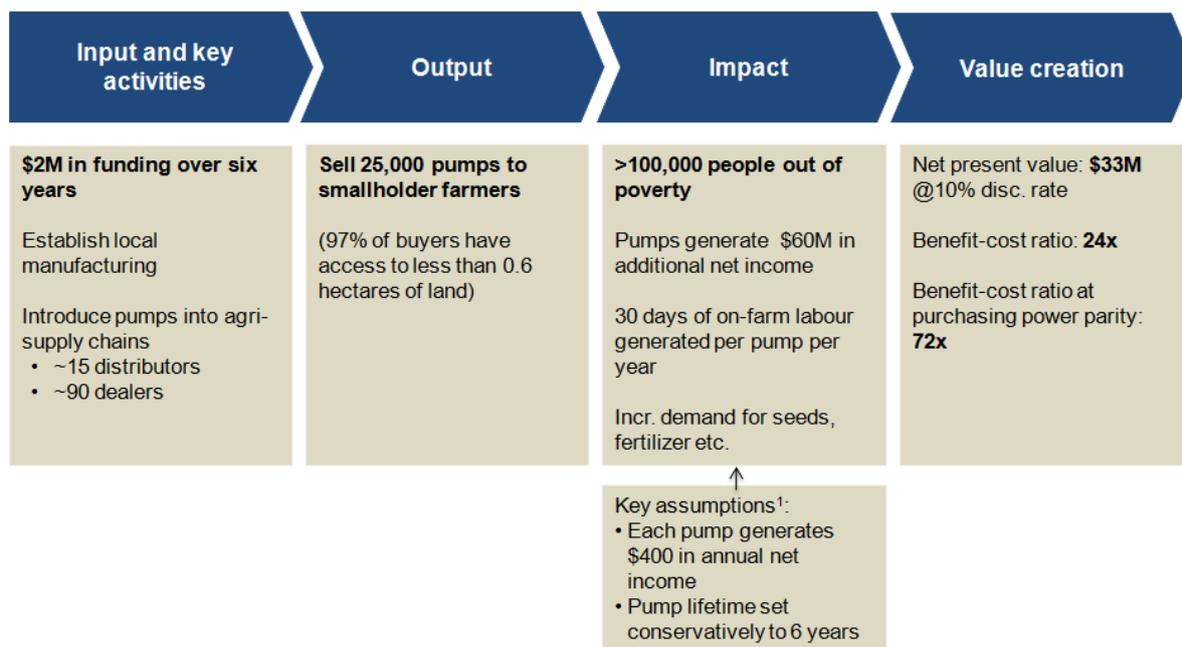
Source: Acumen Fund⁵³

The example above compares the social impact of a grant of USD325,000 for distributing nets for free compared to investing in a factory to produce them. The greater output of the financial option was achieved through leverage of the investment capital and economies of scale. Dividing the value of the social impact with the net cost, which is lower in the investment option since they charge an interest rate, produces the BACO ratio. In this case an investment gave more “bang for the buck” than a grant of the same size.

In addition, only the impact of the actual nets is compared, as decrease in malaria, while the social impact of the job opportunities at the local net factory is not taken into account, since that is not comparable to charitable donation. The analysis hence includes only the part of the social impact that would have been present when making a charitable grant, and taking job creation and other social impact factors into account social impact would have been even greater.

Voxtra is a foundation, presently working mainly with grants but also expanding into impact-first investment at concessionary rates. Using benefit/cost ratios for both grants and investment they calculate the Net Present Value of an investment to measure the impact in monetary terms. The example below shows part of the methodology employed to calculate the social impact of an investment into a program for the creation of a full value-chain for small-scale water pumps for agricultural use.

⁵³ “Acumen Fund Concepts - The Best Available Charitable Option”, 2007, www.acumenfund.org



(1) Not all assumptions underlying the value creation estimates are included in this slide.

Voxtra

31.05.2010 | 1

Source: Voxtra Foundation

THVF has chosen a profit-first investment strategy for their investment fund in Rwanda, and currently “manages the only US-based Africa investment fund that is financed entirely by private money”⁵⁴. Discourse in the on their webpage revolves mainly around the financial possibilities⁵⁵, and the same goes for the company’s statements through media. There are some expressions about the social impact the fund produces, especially from the investors in the fund⁵⁶. While frowning upon specific social metrics, they instead believe in the intrinsic good of responsible investment into entrepreneurial activity.

While not an organization but rather a cooperative project⁵⁷ between several blended value investors, **IRIS⁵⁸(Impact Reporting and Investment Standards)** is an attempt to create a standardized reporting system for social and environmental impact. It is not a set of metrics but a reporting standard, a collection of indicators and proxies, from which various metrics can potentially be calculated. Rather it is an attempt to make a social and environmental impact version of the GAAP⁵⁹ financial accounting reporting standard that they hope will be used by a large number of actors who can then compare impact, in the time of writing it is still under development and its diffusion remains to be seen. One problem with including IRIS in the study is that it is under development but it will still show some general areas of measurements even if a lot of additional levels remain.

The complete reporting standards are too numerous to report here, instead the main categories of

⁵⁴ www.thvf.com

⁵⁵ “Huge potential to tap”, The Banker, 5/20/08,

⁵⁶ Harris, Worth Magazine, 08/01/2007

⁵⁷ B-lab, Acumen Fund, Rockefeller Foundation, Deloitte, PriceWaterHouseCoopers - www.iris-standards.org

⁵⁸ www.iris-standards.org

⁵⁹ Godeke & Pomares, 2009, page 122

indicators are shown with a few examples in each category. The indicators include yes/no questions, percentages, absolute numbers, monetary values or written information.

| Indicator Category | Indicator Examples |
|-----------------------------------|--|
| <i>Common Descriptors</i> | |
| Description | Year founded, Countries served, Legal structure |
| Meta-Layers | Size (Employees), Target population served, Operational model of organization |
| <i>Financial Indicators</i> | Revenue, Income growth, Total Assets, EBITDA |
| <i>Operations Indicators</i> | |
| Governance | Board of directors independence and diversity, local compliance |
| Jobs | Full-Time employees, female employees, minority employees, skilled employees |
| Wages | Wage paid for full-time, for part-time, wage growth and wage equity |
| Customers | Growth of customers in certain demographic or socio-economic group defined in Meta-layers |
| Suppliers | Value of local sourcing, local suppliers supported |
| Training | Number of employees trained at different skill levels, cost of training. |
| Energy | Energy consumption, percentage renewable sources. |
| Emissions | Greenhouse gas emissions |
| Water | Water use in liters |
| Waste | Waste produced in weight |
| Facilities | Green building practices |
| <i>Sector Specific Indicators</i> | |
| Agriculture and Artisanal | Type of product, total sales, export share of sales |
| Energy, Environment and Water | Type of product, units produced, number of individual gaining clean water access |
| Education | Number of previously unserved students given access at different education levels, teacher/student ratio, drop-out rate |
| Community Development Finance | Affordable housing units constructed, new businesses in community, value of mortgages provided in low income communities |
| Healthcare | Type of product or service, caregivers employed, healthcare capacity |
| Microfinance | Loan size, percentage female clients, loan-related training |

Source: IRIS Standards, www.iris-standards.org

5.2 Metrics Analysis Systems

After looking at a few examples above, this section describes some notable categories of metrics into which most systems fall.

After defining a number of impact indicators like in IRIS, there are a number of ways different of calculating and evaluating the impact, the BACO ratio previously described is a good example of such as system. There appears to be more systematic studies⁶⁰ on the calculations than the actual choosing of the proxies, probably cost most measurement systems dictate defining proxies for each specific separate social purpose. Fundamentally, there are 2 overarching methods of calculating impact; cost/benefit analysis and cost/effectiveness analysis, a lot of more complex methods are variations of these.

*Cost/effectiveness Analysis*⁶¹ – A ratio that describes cost per non-monetary benefit, like cost per child cured of malaria as a result of an intervention, basically measures the “bang for the buck” of a particular program. As a measure it’s easily understandable but cannot be used for comparison of different types of impact.

*Cost/benefit Analysis*⁶² – This is a way to through proxies calculate a net present value of an investment, and deducting the cost for it to get the net benefit number. This is used by among others the Voxtra Foundation as it through its monetization process allow for comparison of social returns between different areas, given valid proxies.

*Social Return On Investment (SROI)*⁶³ – A type of cost/benefit analysis as it uses a 5-year horizon with a discounted value of the social impact of a particular project. For example the discounted 5-year societal benefit of employing an ex-criminal, the societal benefit being what the person refrains from stealing based on numbers of what they used to steal⁶⁴. Naturally this approach depends heavily on assumptions and subjective judgments, but it should be remember that so does its equivalent in traditional pure profit-driven investment.

5.3 Impact Themes

In this chapter impact themes from various organizations are collected and sorted into categories, to give an image of what is being measured, and therefore what the goals are. This is a key section since these impact themes are directly comparable to the development goals described in the theory chapter.

Most organizations employing social metrics use metrics that are rather specific to the vision of the venture in question, often since their vision is directed at a specific cause and if they are donor-funded the donors might not provide incentives for measuring impact beyond the particular vision. Such causes could be things like gender equality, democratization, or free press development⁶⁵. While issues like these might have an impact on economic growth in the long run, the impact themes included here

⁶⁰ Tuan, 2008

⁶¹ Tuan, 2008, Appendix G

⁶² Tuan, 2008, Appendix H

⁶³ ”A guide to Social Return on Investment”, 2009

⁶⁴ ”A guide to Social Return on Investment”, 2009, page 41

⁶⁵ Media Development Loan Fund: World Economic Forum Report, 2006, page 21

are the ones with a more direct relationship to economic growth.

Supply-chain Related Metrics

The use of local supply chains is often a metric since it attempts to measure the trickle-down effect of a particular investment into the economy. A problem with the metric is the definition of “how local?” were the goals of a particular organization will create one definition making comparison to another difficult. In the developed world the vision is more often oriented at a particular community, and local there might mean the same city or even part of a city, while in some developing countries the goal might be more poverty alleviation across the country or even continent, giving “local” a whole other definition. The IRIS framework presently defines local as within a 100 mile radius. There is also the question of how to measure the impact through the supply chain; IRIS measures the monetary value of local sourcing, while others⁶⁶ measures jobs created in supply chain.

Customer

The benefit for customers is often counted in the benefit that the actual product supplies, such as increased wealth through the sales of water pumps for increasing the efficiency of farmers like the Voxtra Foundation⁶⁷. Voxtra also includes the dealers and distributors in their due diligence, and benefits like these are included, although very small benefits can be excluded for practical reasons.

Market Inclusion

This type of metric is often called “customer” as well but has a significant difference from the previously mentioned customer category. This is a measurement of the amount or share of customers who belong to the Bottom of the Pyramid⁶⁸, this approach is adapted by the Acumen Fund⁶⁹ and IRIS reporting units suggest this type of reasoning. If one can account for deadweight⁷⁰, or what would counterfactually had happened without the investment, one can measure the impact in terms of the inclusion of market participants who were previously unable to take part, a mitigation of that particular market failure.

Employment and Wages

The reduction of unemployment is often one of the main and most obvious goals of ventures with social goals, as labor is an integral part of the value creation process. The societal effect of employment is frequently calculated in to different ways, partly as the wages⁷¹ that will flow into the economy as a result of the employment, but also the reduced cost for society in terms of welfare and crime reduction⁷². The latter type of impact is more relevant for developed countries rather than the poorest countries where welfare is largely inexistent, but the fundamental problems of jobs being created in different contexts having different values is still an issue.

When calculating the impact of wage increase and unemployment reduction the SROI methodology

⁶⁶ "Measuring IMPACT Framework Methodology, Understanding the business contribution to society", 2008, page 15

⁶⁷ www.voxtra.org

⁶⁸ Prahalad, 2004

⁶⁹ www.acumenfund.org

⁷⁰ "A guide to Social Return on Investment", 2009, page 56

⁷¹ Tuan, 2008, Appendix J, page 22

⁷² "Measuring IMPACT Framework Methodology, Understanding the business contribution to society", 2008, page 15

includes deadweight, the counterfactual unemployment decrease that would have taken place even without the investment, and this number is calculated often by looking at national statistics⁷³. Displacement on the other hand is the effect of jobs being created might through competition create unemployment elsewhere, either in the same or another geographical area. This is also one of the main criticisms for using it as a metric, not because displacement in itself is a problem but because the incentives the metric itself creates. “Companies will talk about "jobs created" by opening a factory, while ignoring the jobs lost by those who previously performed the processing by hand. This is not to say that factories are bad or that focusing on social benefits is bad -- but social metrics can lead to misrepresentation and distortion in practice, given the incentives they create for donor-dependent or PR-focused companies.” – Fogler, THVF⁷⁴

The Robin Hood Foundation⁷⁵ also includes secondary effects in the effect on the children of the previously unemployed beneficiaries of the investment, mainly in terms of their educational progress, and this highlights the challenge in capturing secondary effects.

Human Capital Formation

The IRIS framework has indicators for human capital such as hours in training programs or money spent on programs and other formal training as indicators. Another additional aspect is the human capital formation that is not formal training but work experience and learning-by-doing, defined as on-the-job and off-the-job-training by WBCSD⁷⁶. While experience gain does not have exact measurements, the social impact of it could be partly caught in wage increases, as experienced workers tend to earn more.

Governance

IRIS here measures indicators such as board diversity, meeting frequency and independence to measure the quality of the governing of a particular venture, while others treat it more like a hygiene factor that has to be in place not to undo the positive impact of unemployment reduction.

Local Capital Market Deepening

When investing with some degree of expectations of financial dividends, it is common to leverage the investments for larger social impact. Additionally, by lending the funds at a locally based bank the investment contributes to local capital deepening. This is more relevant for investments in developing countries rather than investments into disadvantaged communities in the developed world. While no particular metric measuring this effect has been found, Accion⁷⁷, a South-American micro finance provider, claim that “there is a contribution to deepening local financial markets when MFIs [Micro Finance Institute] seek local financing.”⁷⁸, and include the effect as an additional impact, as the main reason for local leverage is not deepening the local financial market but mitigating exchange risk for their microfinance bonds.

Societal Values

Certain methodologies include social impact that have no direct impact on economic growth, but

⁷³ ”A guide to Social Return on Investment”, 2009, page 56

⁷⁴ Source: Email from Robert Fogler

⁷⁵ Tuan, 2008, Appendix J, page 22

⁷⁶ "Measuring IMPACT Framework Methodology, Understanding the business contribution to society", 2008

⁷⁷ www.accion.org

⁷⁸ World Economic Forum Report, 2006, page 11

might be part of reducing government spending, indicators such as “reduced social isolation”⁷⁹ or “improved family relations”⁸⁰, maybe through lessened migration of family fathers⁸¹. Other factors of personal or emotional character do have a clear economic impact, such as confidence and self-esteem; these are rarely measured as social returns of investment but are sometimes mentioned as side-effects, and they have been measured by charities⁸².

Health

Another such factors with a clear relationship to economic growth is health, some methodologies measure health improvements as money saved from not having to go to the doctor as much as a result of a particular intervention⁸³, or as increase in healthy person-years⁸⁴. These 2 methodologies together at least partly cover both the savings from not being sick and the increased income from being healthy, and together would represent the complete social return of improved health. Common among practitioners is also to define health as indirect, non-quantifiable benefit.

Environmental factors

Many environmental factors are fairly easy to measure quantitatively; the absolute numbers or reductions in energy consumption, emissions, water and waste are employed by the IRIS framework. While easily comparable to others monetization is not always straightforward, and there are also displacement effects, an example from the manager of profit-first investor THVF “if a consumer pays a higher price for a fluorescent light-bulb, perhaps they cannot afford kerosene that week and burn charcoal instead”⁸⁵.

Infrastructure

Very large companies that build bridges or roads for their own purposes can impact everything from migration to local business growth⁸⁶. This is mainly relevant for large resource-extracting businesses and will not be discussed in this study as the focus is on investments into entrepreneurial ventures.

5.4 The “No metrics”-Approach

Since the positive impact of investment in entrepreneurial ventures on economic growth is well established, some socially minded organizations and firms choose not to measure their social impact, but focus on making financially viable investment and considering the social impact as a given. The government owned Ghana Venture Capital Fund⁸⁷ is an example of this and so is totally privately funded THVF⁸⁸, which aims to be a full-profit venture capital fund but still has a clear social agenda. In place of using metrics founder Robert Fogler explains: “Instead we have a deeply held philosophy, which is to strive for the condition that if we return to the scene of our investments 20 years from now

⁷⁹ “A guide to Social Return on Investment”, 2009, page 38

⁸⁰ “A guide to Social Return on Investment”, 2009, page 49

⁸¹ Source: Pejman Altafi, Voxtra

⁸² “A guide to Social Return on Investment”, 2009, page 42

⁸³ Tuan, 2008, Appendix H

⁸⁴ Tuan, 2008, Appendix K, page 31

⁸⁵ Source: Email from Robert Fogler

⁸⁶ “Measuring IMPACT Framework Methodology, Understanding the business contribution to society”, 2008

⁸⁷ www.venturecapitalghana.com.gh

⁸⁸ www.thvf.com

and ask all of our partners -- customers, vendors, management, communities in which we do business - - whether they were better off for having us as partners, they will say yes". The fundamental problem according to THVF is that users of social metrics "align their metrics to the perceptions of their donors rather than their intended beneficiaries"

However, even in the case of not using metrics, there is still a valuation process even if metrics are not used, in the prioritizing of different projects. Michael Weinstein of the Robin Hood Foundation states "It's impossible not to do it. If you're making grants, you're placing your bets—you are assigning implicit values to the activities that you fund"⁸⁹. Of course, the situation with grants is somewhat different than with blended value investments, due to the added dimension of financial returns which have its own claim on the priorities.

⁸⁹ Michael Weinstein, Chief Program Officer at Robin Hood Foundation - Tuan, 2008, page 7

6 Analysis: Specific Problems Identified by Development Studies

This chapter will take the needs defined by aid from the theoretical framework chapter, and compare these to the needs blended value investors intend to fulfill, according to their metrics. A number of consequences of the comparison between the goals set by aid and the efforts by investors are discussed. In a key chapter mirroring the specific problems identified in the theoretical chapter, market exclusion, image problems, internal and financial markets and middle class building is analyzed and compared to the metrics of the empirical chapter about social performance metrics.



Figure 6, Research Structure - Analysis Focus

6.1 Market Exclusion

This chapter mirrors the theoretical framework chapter regarding the Bottom of the Pyramid, which is seeing poverty as a result of market exclusion. Some of the metrics and impact themes in the empirical chapter that affect market inclusion are discussed, and how the market inclusion frontier can be moved.

Prahalads thesis in “The Fortune at the Bottom of the Pyramid”⁹⁰, as discussed the theoretical framework, was that the poorest population was excluded from the market, and that they were not too poor to participate but that the market does not make the effort to reach these potential customers. As seen in the metrics employed by different blended value investors, including new people in the market is valued, although not always using those particular words.

Blended value investment is an example of how the market inclusion frontier can be moved downwards in the pyramid, to include people in the market who were previously excluded.

⁹⁰ Prahalad, 2004

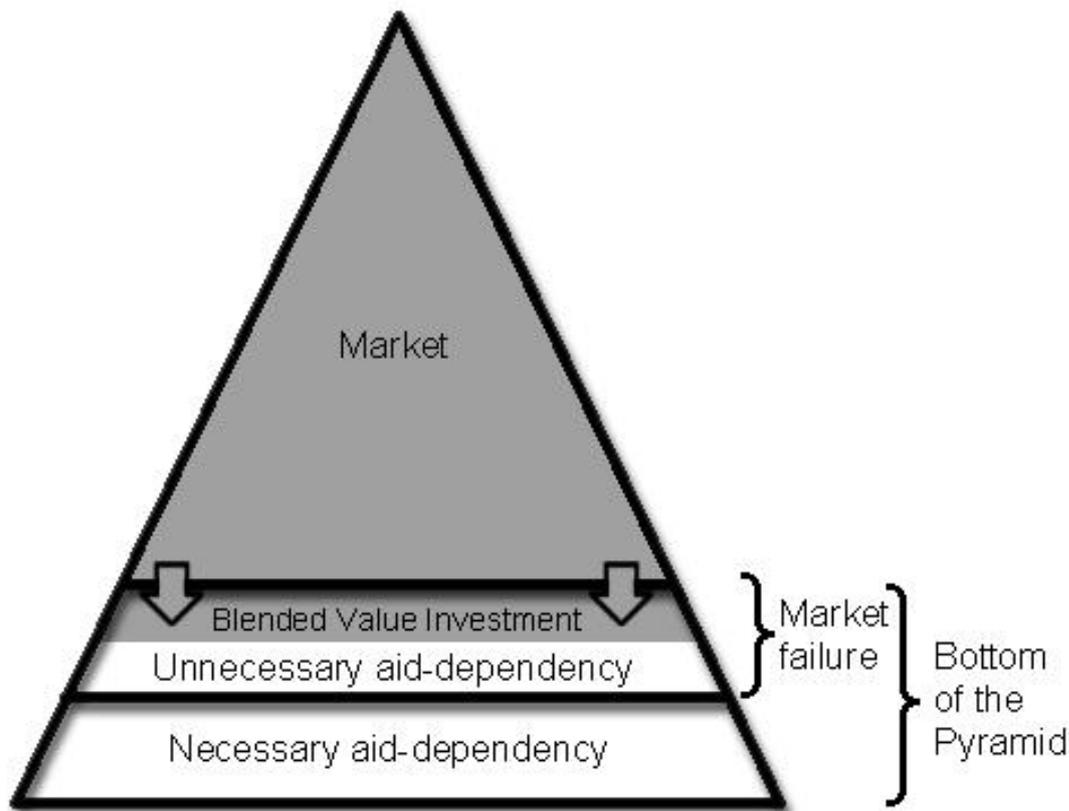


Figure 7, The Bottom of The Pyramid, Continuation from Figure 4, Developed from Prahalad (2004)

Voxtra in annual update state how “there is a limit to how deep into the income pyramid an organization like Voxtra can reach when demanding financial sustainability”⁹¹, this illustrates the decision philanthropic organizations have to make, either leveraging and scaling up their impact, or reach further down the pyramid, to the poorest of the poor. Often purely philanthropic ventures have a preference for reaching the poorest of the poor, whether due to altruism or the marketing opportunities of this group, since pictures of the most extreme poverty generates the strongest emotional response and therefore attracts donations.

The most obvious example of moving the market frontier is microcredit, where individuals or groups who were previously too poor to be included in the financial markets via the banks, are now included through micro finance providers. They did not move up the pyramid and reach a level of financial stability to reach the traditional financial markets scrutiny, but rather the financial market came to them. Therefore commercial microfinance tends to cherry-pick⁹² and lends only to the most solid lender, while philanthropic microfinance can move further down the pyramid.

6.2 Image Problems

In the theory chapter we defined two image problems for Africa, which is here used as an example as it’s an entire continent, but the same could also be true for other countries or communities. These two were both a negative perception from investors abroad, stifling investment, and a negative self-image

⁹¹ Voxtra Annual Update 2008, page 4, www.voxtra.org

⁹² World Economic Forum Report, 2006, page 47

domestically, based on the research of Nobel laureate Maathai⁹³, hurting entrepreneurial activity through lack of confidence. These problems could be mitigated by local, successful entrepreneurs becoming hero-like figures that provide an example of what is possible; much like early entrepreneurs in Silicon Valley helped spawn an entire cluster and show consecutive generations of IT-entrepreneurs what is possible⁹⁴.

Blended value investors could have a contribution in this type of impact, where investment generate buzz around a local entrepreneur which in turns improves the image of the country or region from outside investor and also improves the self-image of other local entrepreneurs. This type of “cultural impact” might not be easily measurable but could be taken into account in qualitative assessments. One possibility of a proxy for this type of impact could be to measure the publicity an entrepreneur receives, like the amount of articles written weighted for size of readership. This is done when scientifically measuring innovation in a country through the amount of publicity innovations receive with the LBIO-method⁹⁵, and something similar could possibly be attempted with cultural impact. There would however be additional weighting issues as “glamorous” sectors like high-tech and entertainment would receive more attention than equally successful businesses in more mundane industries, and in societies with high illiteracy depending more on word of mouth the importance of publicity would be smaller.

There could also be a “big fish, small pond” effects were its easier get attention in a smaller community or even a small country. For example, THVF invests solely in tiny Rwanda and since fewer resources there can create a relatively larger impact, it is likely that it would garner more attention both locally and abroad than the same actual impact in a huge country like Nigeria.

6.3 The Middle Class Consensus

As seen in the metrics and methods used in the field of blended value, most organizations tend to focus on the poorest of the poor, or the Bottom of the Pyramid⁹⁶. This focus is largely a consequence of the *fundamental mismatch*⁹⁷, the mismatch of the social value created by investors not benefitting them directly. As investors tend to invest either for maximizing profit or for maximizing perceived impact, it's with the poorest-of-the-poor that there is the most obvious direct impact and therefore the greatest reward in terms of personal satisfaction. It is also a result of that for attracting donors the marketability of the poorest group are great as pictures of misery would inspire donations more than middle-class developing. Nevertheless, in terms of long-term economic growth we established in the theoretical framework that a strong middle-class is crucial for growth, partly via the political stability it brings. For this reason, the greatest impact in the poorest countries might not lie in reaching the poorest population, but rather in the middle class of those countries.

6.4 Financial Markets and Internal Trade

Aid has shown that pumping in large amount of money into a dysfunctional economy is often

⁹³ Maathai, 1995

⁹⁴ Saxenian, 2006

⁹⁵ Coombs, Narandren, Richards, 1996

⁹⁶ Moyo, 2009, page 57

⁹⁷ Emerson, 2003, "The Blended Value Map", page 91

counterproductive. This is no less the case in dysfunctional financial markets, as the impact of FDI on growth is ambiguous when financial institutions are not in place. In early developmental phases blended value investment wouldn't have a strong impact on the development of the financial market, since the problem is not capital supply. Nevertheless, some microfinance institutions consider leveraging their investments locally as deepening local financial markets⁹⁸, which even though not using a metric shows that it is considered. A development of some sort of multiplier to assess the contribution to the deepening of the local financial market does not seem like an impossible feat.

As for the trade between poor countries, African countries in particular, have been unfortunately low hindering economic growth as a result of tariffs on export. This lack in internal trade could like most of the problems described here be seen as a market failure, caused by weaknesses in institutions and governance. Even though the problem is not only one of capital shortage, blended value investment could take into account their contribution to the bigger cause as discussed in the earlier chapter, something that is not done. Supply-chain related metrics frequently reward "local sourcing" by various definitions, mainly ranging from national down to small sub-national regions, or a 100 mile radius like the IRIS framework. While this is often in line with organizational goals of developing a certain region, especially in the developed world, it can potentially work against a positive development of trade between poor countries. Blended value investments can likely do little to increase internal market development, since it's largely a result of market forces, but at least metrics could be developed not to work against it.

⁹⁸ World Economic Forum Report, 2006, page 11

7 Analysis: Underlying Issues

*The comparison between the specific problems identified by aid and the metrics used by blended value investors presented in the previous chapter described a few key areas where blended value investment could have an impact. In this chapter some of the underlying issues of performance metrics of social impact are presented, as the previous chapter gives the answer to “what could be done?”, this chapter intends to describe why it isn’t. This will be achieved firstly through an analysis of the underlying **incentives** and thereafter the **macro/micro conflict** will be examined where impact can be positive on the individual level and negative on the societal level and vice versa. In a further analysis the idea of blended value will be analyzed in the comparison between the **scale of impact of philanthropy versus Blended Value Investment**.*

7.1 The Incentives of Philanthropy and Blended Value Investment

This chapter describes how some of the problems of aid are based on the fact that the incentives on the individual and organizational level that donation-dependency creates does not always match the goal of the organization. The conclusion introduces the concept of “intermediary philanthropy” where philanthropy and altruism can be practiced while harnessing market forces.

Fundamental mismatch

Part of the argument against using social metrics is that metrics tends to “align their metrics to the perceptions of their donors rather than their intended beneficiaries”⁹⁹. The reason behind this is that the incentives to align the metrics to donors rather than beneficiaries are there, since the investor does not directly benefit from social value creation. This tension is called the *fundamental mismatch* by Emerson and is one of the main challenges in creating coherent social value creation definitions.

The idea of a *fundamental mismatch* is that at the end of the day, humans are rational and self-serving. While this might not be the whole story, a previous section on *behavioral finance* suggests otherwise, it is likely a large part. The main incentives for a traditional profit-investor are financial dividends, but what are the actual incentives for social returns? Either it is a matter of true, selfless altruism or it is the non-material rewards of knowing that good is being done, otherwise known as warm, fuzzy feelings, or possibly the third option of status or recognition among others.

Reality is likely a mix of the three, the tension in between them was described by an investor: “It is easier for people to do pure philanthropy than for them to do for-profit below-market investments because they don’t see it as philanthropy plus, they see it as for-profit minus.”¹⁰⁰

Incentives of Philanthropy

One consequence of the fundamental mismatch is that organizations and individuals that intend to eradicate poverty need to have the goal to make themselves redundant, something that is problematic

⁹⁹Source: Email from Robert Fogler

¹⁰⁰Quote from Woody Tasch, the Chair of Investors Circle, Emerson, 2003, “The Blended Value Map”, page 79

from a behavioral point of view as this will undermine their own status and possibly livelihood. This is pointed out by Moyo¹⁰¹ and she points out that a lot of times they have incentives to disperse money even in lack of viable projects, since a failure to disperse all money might mean that subsequent budgets might be slashed. This causes aid money to flow into even the most corrupt systems something creating more problems than its solving. So even the most well-meaning and altruistic individual work in a system where the incentives are not aligned with their goal, since if the organization was truly successful and eradicated poverty or some other social problem, it would have no reason to exist and its workers lose their jobs.

For the officials of countries receiving aid this becomes even more problematic. Leaders who get a large part of their country's budget from aid flow consequently owe a lot of their own power, wealth and influence to the same aid flows. This creates incentives to perpetuate the flow of aid since actually developing their country would mean aid flows currently under the control of the leaders would cease and be replaced by broader economic growth outside of their control¹⁰².

Incentives for Blended Value Investments

The danger for impact-first investors is that incentives have the problems as the ones for aid, that metrics and even actions itself end up being aimed at pleasing donors rather than fulfilling social goals. For example, a financial intermediary offering investments with social returns at concessionary financial rates to strengthen the economy of a particular community will, if successful, undermine the need for its own existence. The biggest difference however lies in the size of the possible capital pool, as the available global funds for investment are much larger than the available funds for investment. Ironically, even philanthropic foundations often provide more capital to the financial markets than to philanthropy; Emerson urges these foundations: “[Since they] generally give away 5 percent of their assets each year, to think about two other things. One is how to invest the other 95 percent of their endowment in assets that can boost, and not hinder, their larger charitable mission”.¹⁰³

Profit-ventures hence have an intrinsic advantage over social ventures since success and survival are not opposed to each other and don't create conflicting incentives. For profit-ventures self-preservation hence is aligned with the overarching goal, unlike social ventures, and this is one of the problems blended value investment attempts to solve. Another benefit a market approach has, from the investors point of view is that while aid sees a problem in society and aims to solve it, investment in entrepreneurs finds local business that to some degree has developed a working business plan, and the investment merely inflates the success. Through this process the core businesses has to some extent been purified by competition, a “refiner's fire” where inferior models have already lost out. Charitable projects do not have that kind of competition in terms of efficiency.

Intermediary Philanthropy

So far we have defined that blended value investment have a bigger capital pool to tap into if paying market-rate dividends, and that investees with a market-approach aligns the incentives for the individual entrepreneur with the social goals. It begs the question then how a blended value investment then would differ from a typical venture investment? The answer is, there is one part in the investment chain where philanthropy avoids some of these pitfalls, namely in the financial intermediary itself. By applying philanthropic principles here in charging lower fees and working at concessionary salary

¹⁰¹ Moyo, 2009, page 54

¹⁰² Bourguignon & Verdier, 2000

higher dividends can be paid to the investors, or more capital be passed on to investee. A problem could be in the recruitment of skilled staff who would possibly not accept lower wages but this could also work the advantage since it could work as protection from employees who do not share the philanthropic philosophy.

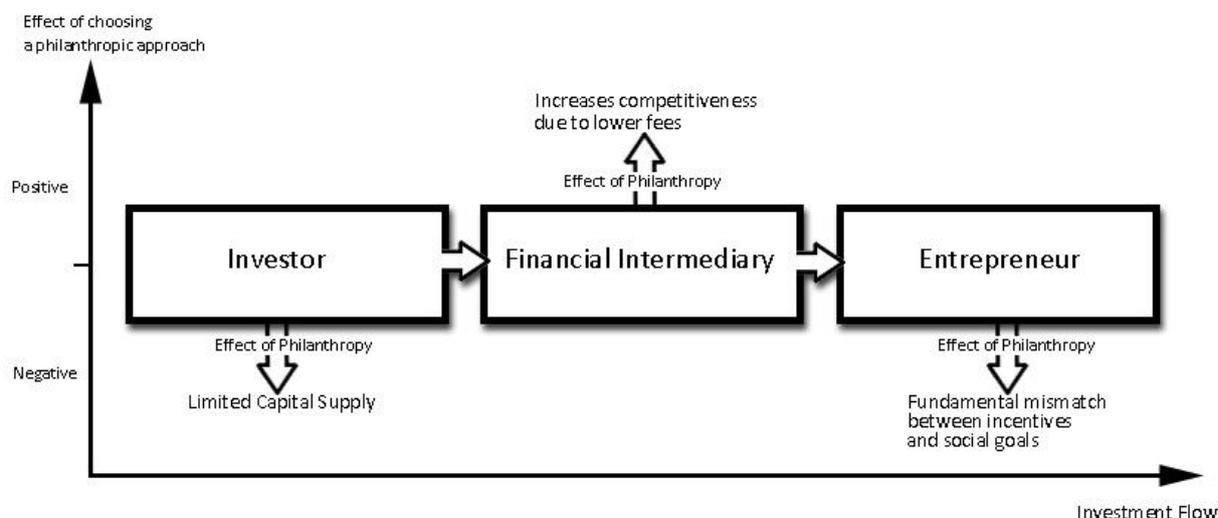


Figure 8, Intermediary Philanthropy

Some of the foundations looked at in this study, such as Voxtra and Acumen, utilize the market forces at the entrepreneur (or investee) stage, but not at the investor stage, as they invest with returns at concessionary rates, but retains the fund for reinvestment rather than passing them on to investors.

7.2 The Macro/Micro Conflict

In this section the difference between micro-impact, the impact on the direct beneficiaries of an investment, and macro-impact, the impact on the society at large, are discussed and the question is whether there are contradictions between these two. A conclusion of this section, and indeed the whole study, is that some investment might not have measurable immediate impact but that its contribution to larger societal or regional change should not be underestimated.

Social performance metrics frequently measure the direct effects and sometimes qualitatively evaluation the larger secondary effects. Consider an investment that improves the economic situation for a certain family, maybe as a result of job creation. A part from the immediate improvement in quality of life due to the salary increase there would be numerous secondary effects such as improved education for the young generation, something that might pay off on a large scale, but not until maybe 20 years later. This could even if taken into consideration likely not be quantified sufficiently for comparison between projects.

In this way, impact can be categorized not only as primary and secondary but also as impact on the organization, community, regional and societal level¹⁰⁴. Primary impact, or micro-impact, is in this study defined as impact directly related to the investment such as the human capital gained or the wage increase of workers directly traceable to the investment in question. Macro-impact or secondary

¹⁰³ <http://money.cnn.com/2002/10/28/pf/investing/emerson/>

¹⁰⁴ Emerson, 2003, "The Blended Value Map", page 79

effects is here defined as social values that contribute to a macro-scale change and where At least in theory contribution to a larger cause could be calculated. These causes are some of the things that have been outlined previously; solving *image problems* and *middle class building*, and an investment couldn't achieve those things alone but rather contribute to the development and possibly trace a share of a change to the particular investment.

Contributions to these larger causes might not be as attractive as direct results to an impact-minded investor, since the reward for philanthropic intentions in many ways is to see improvements in terms of quality-of-life of previously disadvantaged people. In the case of environmental impact however, contribution to a larger issue is the norm; here carbon dioxide offset is a common metric¹⁰⁵. Rarely does one seem the direct effect on the environment by investments, at least for macro-environmental issues like carbon dioxide emissions were one doesn't actually directly improve the quality-of-life for one single person through a smaller carbon footprints, but one could in theory calculate a miniscule share of improved quality-of-life for a very large number of people.

One example of such contribution that is measured in monetary terms is the inclusion of government entities in the SROI methodology, as one of the stakeholders, and increased tax revenue and decreased spending on healthcare of crime fighting are possible positive outcomes of social investment. Even something as unpopular as paying tax could therefore become a joyful experience, and perfectly aligned with goals, for a blended value investor given that the government is trusted to spend it well, this thinking is included in some metrics frameworks¹⁰⁶.

In some cases, measuring the contribution might not be possible, but in some cases keeping the large-scale impact in mind will point out weaknesses and problems with metrics and proxies. To some extent of course, all social values created are contributions to the overarching goal of general economic development or poverty eradication. Sometimes the direct impact is even at odds with secondary effects, and a positive direct impact yields an overall negative result. The creation of new jobs in a community often looks like impressive to stakeholders, especially if displacement effects are not taken into account, displacement being a job created pushing another one off the market in competition. However, even if there would be a strong displacement effect, maybe even giving the investment a negative social impact, the long-term impact might be positive in spite of the metrics of a particular project giving it a negative impact. An example could be that the training of a highly skilled worker or even introduction of a machine replaces manual labor causing unemployment, scoring negatively on most social metrics. This could however be seen as a part of Schumpeterian *creative destruction* which increases the productivity of the whole economy, directly causing increased value creation but likely also attract further investment. Side effects include possibilities for subsequent equality issues, but that would rather be a challenge for policy makers. In these kinds of scenarios, social performance metrics could appear to give negative direct impact could have secondary, and sometimes immeasurable additional impact causing problems for the metric. From this perspective even bankruptcies are not 100% negative, as there can be positive side effects in terms of human capital formation.

¹⁰⁵ Example: E and Co, www.eandco.net

¹⁰⁶ "Measuring IMPACT Framework Methodology, Understanding the business contribution to society", 2008

7.3 The Scale of Impact of Philanthropy versus Blended Value Investments

This chapter compares the impact of grants and blended value investments, based on the concept of a cost/benefit ratio described in the empirical chapter. In the chapter we can see that based on a number of assumptions, that in spite of lower efficiency in terms of a cost/benefit ratio of investments as compared to philanthropic grants, the increased leverage from capital availability can make the overall impact greater.

It can be assumed that the social impact of a philanthropic investment is greater than the impact of a profit-investment, at least when counting social value created per monetary unit, since money can be allocated for one purpose only, for the social impact it has been designated without the “distraction” of also generating revenue. One measurement of such efficiency is the benefit/cost ratio that is used by many to evaluate projects as has been mentioned in the empirical study.

The first assumption for the following model, Figure 9, Scale of Impact of Philanthropy versus Blended Value Investments is that the social value created per monetary unit decreases the more priority the investor puts to profit. This is shown in the model as the sloping line for the *cost/benefit ratio* where the ratio decreases along the *scope* axis for every step up the *market orientation* axis which signifies the priority being put in financial dividends in an investment decision.

The second assumption is that global capital supply for investment capital is far larger than capital supply for philanthropy, and that the supply increases exponentially at higher dividend rates at any given level of risk. The assumption that there is more capital available for investment than philanthropy globally is rather obvious, but even in the non-profit sector we have mentioned that foundations frequently allocate 95% of their capital on the capital markets in order to generate dividends to donate the remaining 5%¹⁰⁷, supporting the assumptions that the capital supply is larger for profit-investment even on the non-profit market. This assumption is represented by the *capital availability* line in the model, and is assumed to increase exponentially due to profit-maximizing nature of investors were at any give risk-level investors flock around the investments given the highest rates.

Multiplying the *capital availability* line at any given level of returns with the *benefit/cost ratio* at any given risk-level would results in the number for total societal impact, represented by the *Impact* line, which eventually will generate greater impact due to the scaling of funds even though social impact per economic unit, or cost/benefit ratio, is steadily decreasing. The consequence of the 2 assumptions is hence that eventually the increasing fund availability will offset the decline in benefit/cost ratio and hence profitable investments will at good enough rates produce more social impact than philanthropy.

¹⁰⁷ Previously referred to in section 7.1, <http://money.cnn.com/2002/10/28/pf/investing/emerson/>

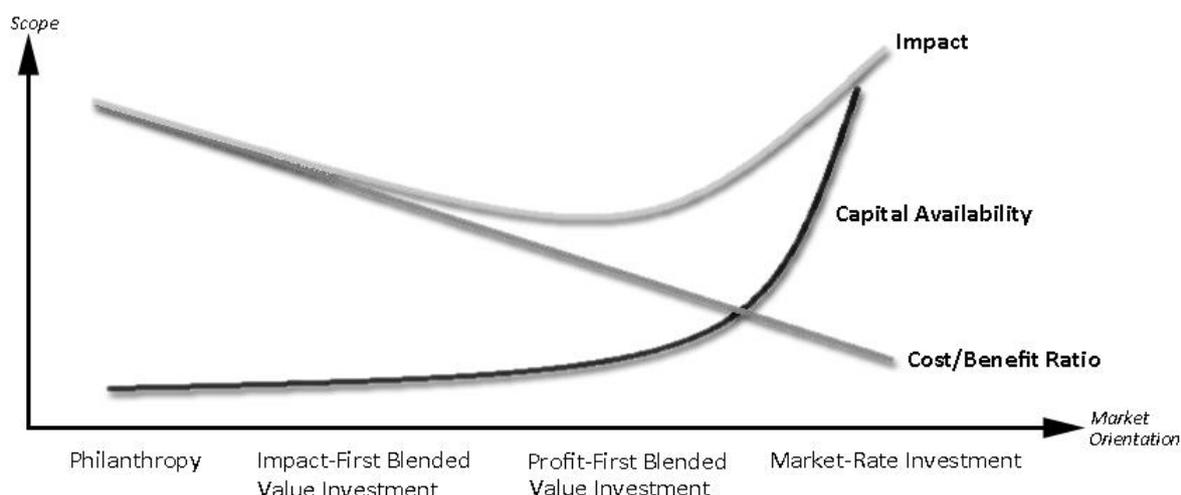


Figure 9, Scale of Impact of Philanthropy versus Blended Value Investment

This is assuming however, that the investments don't have any negative impact, which could be the case, notably in situations with Dutch Disease¹⁰⁸ or Resource Curse¹⁰⁹. Additionally, impact should be thought of as long-term growth and not compared to necessary short-term philanthropic sectors such as orphanages or disaster relief. There is also the assumption that an economy can actually absorb any given amount of investment, something that is not always the case in a developing country context.

One example where this has been seen is microcredit, which often has functioned as a forerunner for other forms of blended value investments, and has been moving up the profit scale and on its way to be a viable investment class without a needing a “socially responsible crutch”¹¹⁰. ProFund, a microfinance provider in Latin America claims: “[They do] not perceive a conflict between Poverty Alleviation and Profitability” and a World Bank report from 2006 states that “the size of the microfinance industry has the potential to be dramatically larger, and philanthropic capital alone will not be sufficient to achieve this potential”. This statement is confirmed by the growth of commercial microcredit, with industry equity of USD363 million in 2004 to USD1.5 billion in 2006¹¹¹.

Outside of the microcredit sector Acumen Fund, investing in various businesses for social impact, has moved from grants to concessionary rates and achieved greater impact that way¹¹².

¹⁰⁸ Neary, 1982

¹⁰⁹ Fofack, 2009

¹¹⁰ Quote from Roger Frank, DWM Managing Director, World Economic Forum Report, 2006, page 18

¹¹¹ Rhyne & Busch, 2006

¹¹² World Economic Forum Report, 2006, page 58

8 Summary

Blended value has in this study many times been compared to aid and development assistance, since this is at least to a certain degree what it could potentially replace. It is however important to mention that there are limits to how “far down the pyramid” the market can reach and that there will always be a need for “pure” philanthropy. Nevertheless, development has to large degree failed to generate long-term economic growth in large parts of the world, and here market-based approached holds great promise for the future.

In the theoretical framework of this study we looked at a number of development problems that development aid has failed to address, defined by often famous writers such as Collier, Sachs and Prahalad, problems often described to be solvable with more efficient aid. Of course, the scope of the specific subjects could be very wide, in this study *market exclusion, financial and internal market development, middle class building and image problems* has been mentioned specifically but this list is far from conclusive.

In the empirical chapter, *Social Metrics*, the presently used social performance metrics and methods used by blended value investors, whether they prioritize impact of profit first, were assessed to define what kind of impact they are measuring. The list of Impact Themes (section 5.3) included employment, market inclusion and human capital formation and represents the types of impact blended value investors are currently aiming for, as metrics act as a proxy for their intentions. And finally in the analysis chapter, we compared the goals defined by development studies to the impact measured by investors to conclude if the goals are fulfilled.

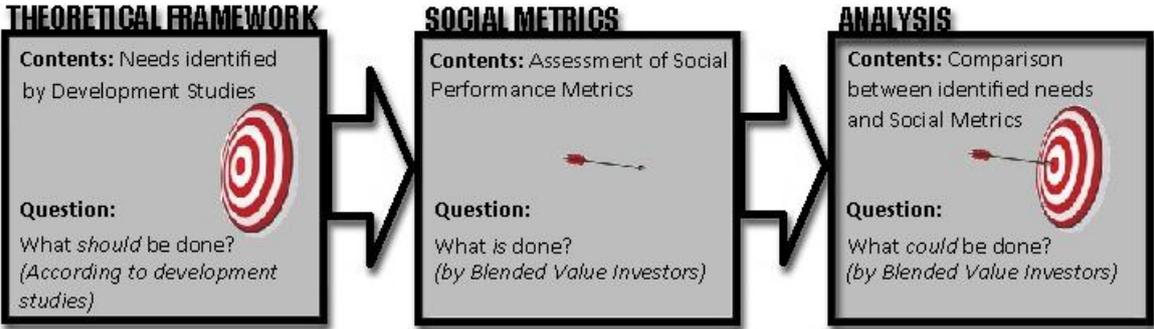


Figure 10, Research Structure

The conclusion regarding the 4 specific issues *market inclusion, financial and internal market development, middle class building and image problems* is that market inclusion is the only one found to be measured to some extent, while financial market development are sometimes mentioned as a non-quantifiable positive impact but not explicitly measured. The main contribution of this study is however not these specific subjects, as many more subjects like these could be defined and compared to the impact of investment. In the additional analysis however, a few underlying issues were identified as common denominators of the mismatch between goals and metrics, the *contribution of investment to macro-change* and *Intermediary Philanthropy*.

One of the main conclusions of this study is the fact that investments with the intention to do social goods not only generate direct measurable social impact, but can also *contribute to large-scale change*, in this study called macro-impact (discussed in section 7.2). Macro-impact might not always be possible to measure, but it should be kept in mind as sometimes micro-level metrics might work against macro-level goals. Organizations, especially donor-funded ones, tend to focus on social impact that yields immediate measurable results that can be attributed to their investment in particular. Commendable as this is there are larger questions were investments can *contribute* to larger-scale social change, these larger scale issues are not attractive in terms of attracting donors but can be better affected with profitable investments. The specific issues identified, *middles class building*, *development of financial and internal markets*, *market inclusion* and issues regarding the *image* of countries are issues where investment can contribute to a positive development. It might not always be measurable but if not taken into account some of the short-term goals might counteract these larger scale changes.

Another cross-cutting conclusion is that due to a large self-serving portion of human nature, the capital available for profitable investment will always be far greater than capital available for philanthropy. This gives blended value investment an opportunity to leverage the impact and scale it up compared to philanthropy, as described in section 7.3, and this can create larger impact than a purely philanthropic option even if the cost/benefit ratio is lower.

In addition, philanthropically minded entrepreneurs can be a great force for change in a community, but will due to concessionary rates not be attractive to investors not accepting concessionary rates and might also warp the market by for example selling products underpriced for philanthropic purposes. This leaves the philanthropy being most effective in the intermediary stage, in this thesis dubbed *intermediary philanthropy*, discussed in section 7.1, where a philanthropic approach means cutting the financial intermediaries share while still tapping into the capital markets and not warping the local market in which investment is made, and this might even increase the competitiveness of the intermediary.

8.1 Suggestions for further research

The most obvious track for continued research on this subjects is to identify further development issues through the failures of aid and investigate how blended value investment can address these, examples mentioned in passing include corruption, property rights and political stability all of which are primarily institutional problems but where investment could contribute to positive development or at least not contribute to a negative one.

As a qualitative study the conclusions of this study are not measured but are rather presented as theories and hypothesis, this opens a lot of opportunities for quantitative testing of a number of issues such as the potential trade-off between impact and profit as described in Figure 9, or whether the contribution to macro-change by single investments can be measured.

Some of the theories could be developed into specific metrics, it has been mentioned in passing that the problem of a negative perception of an area can be improved by investment into ventures that create “entrepreneurial heroes” that through their fame increases confidence in subsequent local

entrepreneurs, and how this could be measured through publicity. Other metric development could include some kind of multiplier for capital deepening in local economy, something that is sometimes taken into consideration but not measured in any of the frameworks studied in this study.

The subject of investment and the middle class consensus could also be quantitatively studied through a comparison of actual middle class, as measured by income, and “potential middle class”, as measured by education, to see if capital investment is the missing factor in developing the middle class.

8.2 Concluding notes

The list of suggestions for further research could go on for much longer, and it is clear that since the subject is in its infancy there are very large amounts of research left to be done in the subject. There are a lot of signs that the subject will grow both in practitioners and in the academic world and that it will be major force in global development in the future.

8.3 Credits for interviews, emails and advice

Pejman Altafi - Voxtra

Shervin Setareh – Dalberg Global Development Advisors

Jed Emerson – Stanford University

Robert Fogler – Thousand Hills Venture Fund

Edi Theiler - Bridgeworks

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