LABORATÓRIO DE INVESTIMENTO SOCIAL

FUNDAÇÃO CALOUSTE GULBENKIAN

IES SOCIAL BUSINESS SCHOOL

supported by: SOCIAL FINANCE

RESEARCH NOTE #1

GLOSSARY FOR THE CONVERGENCE ECONOMY

2014

This research note was developed by Professor Filipe Santos from INSEAD, scientific supervisor of the Social Investment Lab. It aims to create a common language and introduce readers to the key concepts in the Social Entrepreneurship and Innovation sectors, with a primary focus on Social Investment.

SOCIAL INVESTMENT LAB

The Social Investment Lab is an initiative promoted by the IES-Social Business School and the Calouste Gulbenkian Foundation in partnership with Social Finance UK. It is intended to be a leading knowledge centre in the area of social investment, seeking to disseminate international best practice and innovative financial instruments, and to study its applicability in Portugal.

INTRODUCTORY NOTE FROM THE CALOUSTE GULBENKIAN FOUNDATION

The Gulbenkian Human Development Programme encourages and facilitates the inclusion of the most vulnerable groups in society, through a commitment to social innovation, entrepreneurship and empowerment of people and organisations as keys to development.

There are in Portugal and the Portuguese-speaking world a large number of high impact projects facing numerous financial difficulties which prevent them from achieving their full potential.

Fortunately, financial innovation in recent years has come up with new solutions and tailored them to the specific needs of social organisations and entrepreneurs, particularly in Anglo-Saxon countries. These innovative financial mechanisms are intended to increase the amounts available and diversify sources of capital to finance the social sector.

The main social problems - e.g. the number of children in care, unemployment, school drop-out rates, homelessness, criminal recidivism, social isolation of the elderly and so on - represent a huge economic and social cost. On one hand, we are fortunate to have organisations and social entrepreneurs who devote their effort, skills and professional lives to finding solutions to mitigate these social challenges. On the other hand, there is a lack of appropriate financial instruments to support these entities in the long run and ensure financial sustainability, in order to maximise their impact and improve the quality of life of their beneficiaries.

Calouste Gulbenkian Foundation’s support, through the Gulbenkian Human Development Programme, for the Social Investment Lab is fully aligned with our mission and aims to propose solutions for those working with vulnerable populations, so that they can do it in a way that is increasingly efficient, capable and achieves greater impact.

This is a process of learning together, with the involvement of key players in the financial, social and public sectors, to propose solutions that enhance the quality of life of the most vulnerable populations, reduce the level of poverty and strengthen social cohesion.

GLOSSARY FOR THE CONVERGENCE ECONOMY – SOCIAL ENTREPRENEURSHIP AND SOCIAL INVESTMENT

THE NEED FOR A GLOSSARY ON THE CONVERGENCE ECONOMY

Western capitalist society has developed a markedly sectoral model in which the private sector develops and extends markets in multiple areas, helping create wealth and employment; the public sector ensures market regulation, the supply of public goods and the basic functions of a welfare state, while the social welfare sector focuses on social inclusion and support for the most disadvantaged segments of society. Despite strong economic and social development since the Second World War, there are many social and environmental problems that are complex, deeply rooted and difficult to address. Some are local, others are systemic. Some are invisible to society, others are evident but difficult to resolve with existing solutions.

It is in this context that from the late 1970s a new movement known as social entrepreneurship has arisen in society. It is the awakening of citizens as entrepreneurial agents focussed on problem solving and working in partnership with various sectors. The growth of this movement is triggering a major transformation in the behaviour of players from each of the three sectors, engaging them in growing dialogue and joint initiatives. It is this increasing interconnection between sectors which we call the Convergence Economy. At the centre of the **Convergence Economy** is the growing social innovation and entrepreneurship sector, including the emerging area of impact investment or social investment. This sector is a catalyst for many of the changes, partnerships and innovations of the last decade.

The assessment, promotion and capacity building in this sector of social entrepreneurship and its agents of change are the focus of the work and mission of the Institute for Social Entrepreneurship (IES). This glossary aims to create the language and basic concepts in Portuguese for the social innovation and entrepreneurship sector, with the primary focus on social investment.

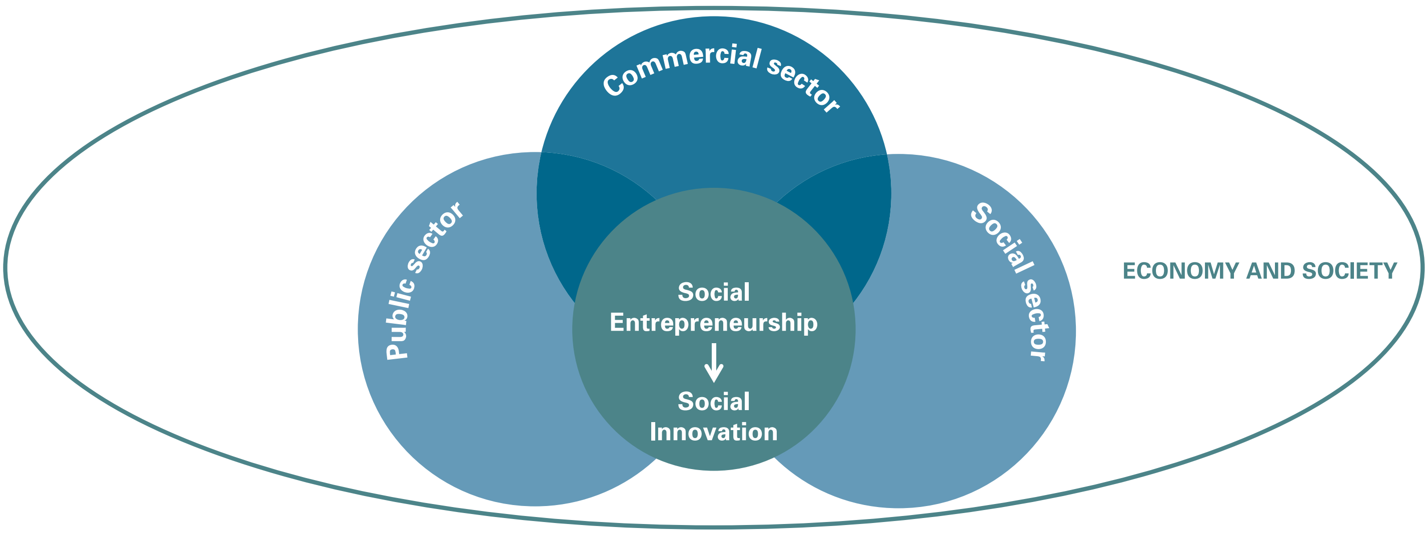

Figure 1: Positioning of the Convergence Economy
Source: IES, 2013

KEY CONCEPTS

Social Entrepreneurship: the process of developing and implementing sustainable solutions for neglected problems of society. This process can take place in different organisational contexts (e.g. a third sector organisation, a company, a public institution, or through a new organisation). Social entrepreneurship has some core principles that include prioritising the delivery of value to society, a focus on innovation with regard to established rules and solutions, the pursuit of sustainability principles in the designed solution and the commitment to empower the main participants in the value chain. Social entrepreneurship is thus different from, both the traditional approach to charity and the models of commercial entrepreneurship. The financing of social entrepreneurs and their innovations is one of the main focuses in the area of social investment.

To find out more go to:
Social Entrepreneurship Institute,
www.ies.org.pt

Social Innovation: a distinct solution to a social problem with proven positive and superior impact to existing solutions, taking into account the opportunity cost of the resources used. A social innovation should, ideally, be simple in conception, replicable for other contexts and based on cheap and abundant resources or on highly scalable resources and business models. Social innovation is thus the successful outcome of the process of social entrepreneurship. Given the difficulty in codifying and replicating social innovations, social investment has a focus on financing the dissemination of social innovations.

Social Enterprise: a for-profit organisation that applies business principles (sale of goods and services), with the priority objective of maximising the creation of value for society in its field of expertise. In social enterprises, the demand for profit for the owners of the organisation is constrained (by statute and/or practice) by the purpose of delivering value to society. The social enterprise seeks to achieve its mission, while fairly remunerating the resources that it uses in its activities (including financial capital and human capital), seeking to identify and eliminate any negative impacts that its actions may cause. A more restricted variant of the social enterprise proposed by Muhammad Yunus is the **Social Business**. In this variant, profits should only be reinvested in the growth of the organisation or in the pursuit of its social mission, and they should not be redistributed. While there is still no legal status for the social enterprise in Portugal or in almost any other country, several have been made to certify companies as being social, B-Corp being one of the best-known models. Given the lack of legal status, the English generic term "social enterprise" is sometimes used to classify all organisations with a social mission and business model based primarily on the sale of goods and services, even if they have the legal status of a non-profit organisation. In our opinion, social enterprises should work on the principles of social entrepreneurship described in this glossary. More than legal status or distribution of profits, it is the correct application of these principles which makes them social enterprises. Given that social enterprises are seen as hybrids between commercial enterprises and organisations of a more paternalistic character, they suffer from lack of funding mechanisms and capacity-building activities. Hence the importance of the emerging area of social investment.

To find out more go to:
Social Enterprise UK,
www.socialenterprise.org.uk

Capacity-building: the process of strengthening the abilities and competencies of individuals, organisations or communities so they can carry out their work and most important functions with quality and sustainability, embarking on a process of continuous improvement. When applied to individuals, this is particularly relevant to the development of leadership and management skills that are useful in the design, implementation, monitoring and growth of social impact projects. When applied to organisations, this refers to the strengthening of administrative structures, models of resource mobilization and stakeholder management, quality management processes and governance of organisations. When applied to communities it refers, in particular, to the development of their own identity, cohesion and confidence among the members of a community, aligning around goals that enhance the well-being of the community. Investments in capacity-building are essential for economic and social development, but are often forgotten or ignored by funders. The area of social investment has a particular concern with capacity-building.

Impact investing or Social Investment: the application of capital to activities, organisations or funds in order to simultaneously obtain a financial return and a value return to society, both of which are monitored and influence the investor decision-making. Among impact investors there are those **that prioritise profit (profit-first)** by achieving an established level of impact, and those **that prioritise impact (impact-first)**, by achieving a set return. There are also the **for-profit investors with impact** who don't believe in choosing between maximising profit and maximising impact. These investors seek to act in areas where profit and impact are strongly correlated. The term impact investing was originated in the USA and is typically limited to the application of resources in which there is some expectation of financial return. The term social investment has its origins in the United Kingdom and is typically used to describe the application of resources and investments in social sector organisations. The two terms have been converging and are often used as synonyms.

Social Finance: an investment approach in social organisations and/or social interventions that seeks to introduce market principles based on transparency, efficiency and effectiveness in the allocation of resources vis-à-vis the results that are expected to be obtained. The products developed by the Social Finance sector, such as social impact bonds (SIBs), are intended to set synergistic links between the market and the social, private and public sectors.

Social Impact Bonds – SIBs: new types of contracts for innovation in public services based on results. In these contracts, public authorities are committed to pay the investors a financial return given a proven social impact. The amount invested upfront is delivered to social organisations which provide services and achieve the results stipulated in the contract. An intermediate entity manages the application of funds and the monitoring of results. In cases where results are not achieved, the investors will receive a lower compensation, or even undertake the risk of losing their initial investment. In this way, the risk of social innovation rests on private investors and not on public budgets, while social organisations have medium/long-term financing guaranteed. A variant are **Development Impact Bonds** in which the same concept is applied in developing countries, with international organisations, such as Foundations or Cooperatives, taking on the role of public authorities in the support of specific humanitarian causes such as the fight against malaria or support to primary education. Despite being a recent innovation, social impact bonds have become very popular and are being replicated in several other countries.

To find out more go to:
Social Finance UK,
www.socialfinance.org.uk

Impact Assessment: the process of analysing, calculating and monitoring changes, both positive and negative, resulting from a particular intervention (for example an initiative, programme, project or organisation). As far as possible the impact must be translated into indicators that can be quantified. The monetisation of these indicators is possible, but not required. There are a variety of impact measurement methodologies, although none is accepted as a global reference. On the measurement of impact, it is essential to have a correct understanding and application of the logical model to the organisation or project in question, in order to measure the impact on the problem which has caused the social intervention and its creation of value for society.

Logical Model: a sequence of conceptual steps to explain how an organisation with a social mission can achieve impact. The logical model starts from the resources (human, financial, material, knowledge) that are used in activities (the concrete actions that take place) that lead to products (goods or services supplied to customers and/or beneficiaries) who have results (changes achieved with the performance of the organisation) that in turn lead to impact (significant and sustainable change in society). The logical model explains how an organisation achieves impact and how this can be measured and monitored both for internal management improvements and for comparison between social investments.

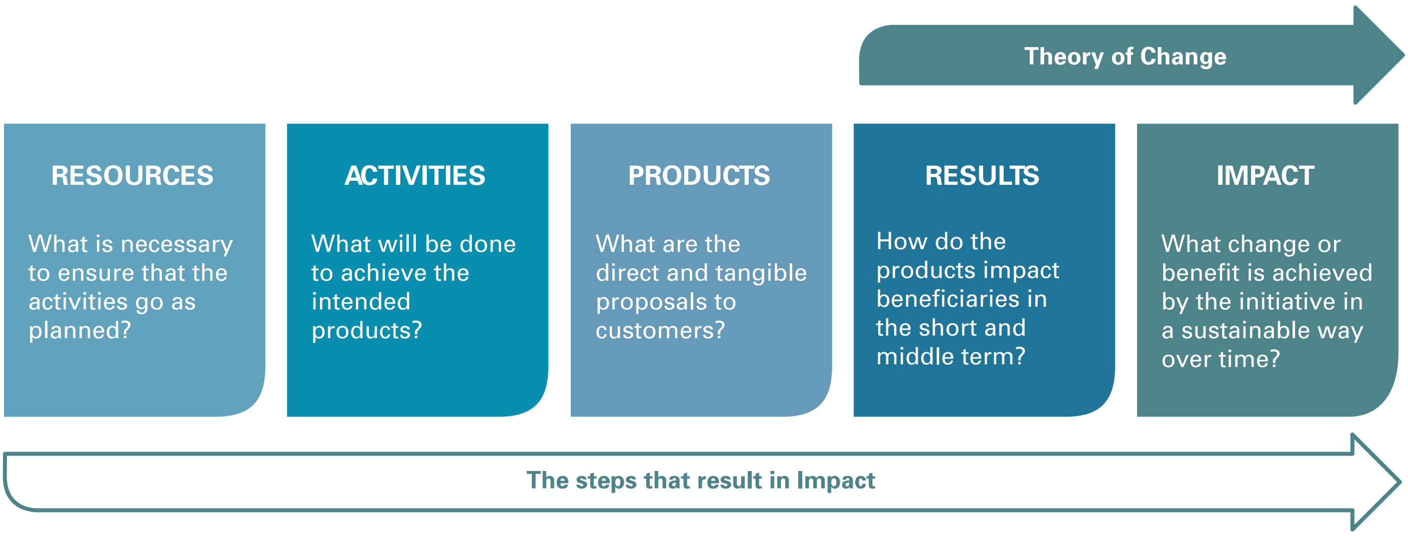

Figure 2: Logical Model
Source: IES, 2013 (adapted from Manual para Transformar o Mundo)

Theory of Change: a logical argument that explains how the performance of an organisation with a social mission will lead to the creation of value for society, in addition to the direct benefits that their goods or services have on customers. This argument is articulated as a working hypothesis that must be validated, step by step, and/or adapted so that the organisation can create the greatest possible impact. The theory of change explains, in terms of the logical model, how the short and medium term results of the organisation lead to impact, through the systematisation of all the spillovers of value to society caused by the performance of the organisation.

Third Sector or Social Sector Organizations: organizations that seek to solve society's problems, in particular those problems that affect populations that are more excluded, unprotected, neglected or discriminated against. These organisations can have a varied set of legal structures, including Association, Foundation, Cooperative, Charity, Mutual Association, or even take the form of an informal organisation. The financing of these organisations is one of the central objectives of social investment.

Grants: resource allocation by philanthropists and sponsors without the requirement of any financial return or return of capital. This has been the most traditional way of financing the social sector, along with public sector payment for services provided. These two forms of financing have the disadvantage of not being normally associated with the real results of organisations and do not allow for long-term investment in the capacities of social organisations (capacity-building of organisations). Thus, we increasingly see a worldwide trend to diversify sources of revenue by social organisations, which are looking for more sustainable models associated with impact. This is a motivation for the emergence of the social investment area.

Base of the Pyramid – BoP: a set of business activities by multinational corporations and social entrepreneurs focused on serving customers of limited economic means who are often among the poorest segments of the population, (typically defined as having an income of less than $2 a day). The concept originated with authors C.K. Prahalad and Stuart L. Hart and became popular in 2004 with the book "The Fortune at the Bottom of the Pyramid". BoP strategies have evolved and look for the poorest people not only as potential customers, but also as producers, distribution partners and agents of innovation. These ideas have been adopted by many multinational companies to rationalise their investments in developing countries and led to a wave of innovation in low cost business models, normally called inclusive business models.

Inclusive Business Models: financially sustainable business approaches that are designed and implemented to benefit low-income populations or those normally excluded from the market. They aim to combat the so-called "Poverty penalty" that is evidence that low-income populations do not have access to essential goods and services and, when they exist, are often more expensive than those offered to middle-class populations. These business models use innovative approaches such as the direct involvement of customers in the solution, direct subsidy between segments, the use of members of the population as commercial agents (micro-franchise), the use of technology in the construction of the value chain in order to lower the cost of operations and resource utilisation under- -valued by society.

To find out more go to: WBCSD-SNV Alliance, www.inclusivebusiness.org

Venture Philanthropy: an investment mechanism in social entrepreneurs and their innovations which includes both financial and non-financial resources like counselling, access to networks and other forms of training. Venture philanthropy may include impact investments or more traditional donations or a combination of the two components. However, there are some common features such as a high level of interaction with the investee, design of tailor-made financing solutions, pluri-annual support, training and monitoring of the impact. Venture philanthropy is particularly useful at a time when the social organisation is validating its impact, encoding its solution and preparing to engage in a process of growth. This field has been growing markedly, in particular in Europe and Asia, and has its own Associations (EVPA and AVPN). Member are usually Foundations that are changing their investment strategy as well as Social Investment Funds.

To find out more go to: European Venture Philanthropy Association, www.evpa.eu.com

Layered Investment Structures: an investment contract that combines features of different types of financial investors to better achieve its objectives. A complex structure can, for example, combine the following structures: an investment that prioritises profit in the capital of a social enterprise, associated with a long-term loan from an investor who prioritises impact, a bank guarantee from a foundation and a donation for a capacity-building project. The possible combinations are virtually endless and this is one source of innovation in the field of social investment.

Family Office: a private organisation whose mission is to manage the funds and investments of wealthy families. This may be an office dedicated to the needs of one family (single family office) or position itself to serve different families (multiple family office) thus achieving economies of scale and experience. In the latter case, the office can be part of an investment bank and/or wealth management department, or be created in partnership between several families. Family investment offices have been among the pioneering organisations in the adoption and promotion of the principles of social investment, given the natural concern of the household members for long-term social well-being.

Microfinance: the provision of financial services such as credit or insurance, to vulnerable segments of the population that are normally overlooked by the financial system. The great success of microfinance has been microcredit which was developed in the 1980s mainly in Bangladesh as a sustainable market offering to finance microentrepreneurs. In just twenty years, microcredit has become a global industry with thousands of organisations and backgrounds. At the moment there are a variety of microfinance offers including microloans for houses, savings accounts, and life or agricultural microinsurance.

Socially Responsible Investing - SRI: an investment model that normally uses a negative filter in the selection of investments and refuses to allocate resources in organisations which have negative impacts on society (e.g., tobacco companies, alcohol or weapons), or refuses to invest in companies that do not use ethical criteria for their economic, social or governance performance (ESG). Nowadays, there is a large volume of funds amounting to more than $3 billion being invested in SRI. However, the SRI investment sector is usually not regarded as part of the social investment area, which uses a positive impact filter to select investments.

*To find out more go to:
Forum for Sustainable and Responsible Investment,
www.ussif.org*

LABORATÓRIO DE INVESTIMENTO SOCIAL

This research note was developed by the Social Investment Lab under the scope of the project "Portuguese Social Investment Taskforce", launched in 2014 with the aim of catalysing the social investment market in Portugal. This one-year project was financially supported by the European Commission, through the program: Supporting the demand and supply side of the market for social enterprise finance.

This piece is part of a series developed by the Social Investment Lab, whose contents should reach organisations, social entrepreneurs, investors and various public sector agencies, and help create key knowledge on social investment. The objectives of the research notes are to identify the needs of the sector, introduce new concepts and instruments, to reflect on what has been done in other countries and to promote discussion about the potential implementation of social investment in the Portuguese situation and the Portuguese-speaking world. We invite readers to ask questions, make suggestions and share ideas via email at investimentosocial@ies-sbs.org.

Funded by the European Union

PARTNERS:

IES – Social Business School
IES-Social Business School is a non-profit association which aims to stimulate innovation, efficiency and the growing impact of transformative projects that break problems traps in our society. The vision of the IES-SBS is to be the benchmark for social entrepreneurship in the Portuguese-speaking world, fostering innovation, knowledge, learning, and social impact. The work of the IES-SBS is focused on training and promoting high potential social entrepreneurship initiatives, along with exceptional organisations and individuals committed to change the world in the most efficient and innovative way. The mission of IES is to Inspire and Empower for a better world, through Social Entrepreneurship.

Calouste Gulbenkian Foundation
Calouste Gulbenkian Foundation is a private Portuguese institution for public use whose statutory aims are the Arts, Welfare, Science and Education. With over 50 years of experience, the Calouste Gulbenkian Foundation works extensively in Portugal and abroad through its own initiatives or in partnership with other organisations, and through the provision of grants and scholarships. The mission of the Gulbenkian Human Development Programme, created in 2009, is to encourage and facilitate the inclusion of the most vulnerable groups in society.

Social Finance UK
Social Finance was established in 2007 and is a non-profit organisation that works with social organisations, investors and the public sector in the development of financial mechanisms tailored to the needs of the social sector. Social Finance launched the first Social Impact Bond in HMP Peterborough, attracting an investment of £5 million from 17 investors, with the aim of reducing the recidivism rate. The Social Finance team consists of experts from the financial, social, public and private sectors. This team has from the start supported the UK Social Investment Task Force, the Commission of Unclaimed Assets and was involved in the creation of Big Society Capital, the UK social bank.