

# Community Development INVESTMENT REVIEW

[www.frbsf.org/cdinvestments](http://www.frbsf.org/cdinvestments)

## Articles

Mission Insurance: How to Structure a Social Enterprise So Its Social And Environmental Goals Survive Into the Future

*Kevin Jones, Good Capital*

Exploring the Continuum of Social and Financial Returns: When Does a Nonprofit Become a Social Enterprise?

*Kathy Brozek*

Using High-Transparency Banks to Reconnect Money and Meaning

*Bruce Caban*

Impact Investing: Harnessing Capital Markets to Solve Problems at Scale

*Antony Bugg-Levine, Rockefeller Foundation, and John Goldstein, Imprint Capital Advisors*

Increasing Access to Capital: Could Better Measurement of Social and Environmental Outcomes Entice More Institutional Investment Capital into Underserved Communities?

*Lisa A. Hagerman, College Institute for Responsible Investment, Oxford University Centre for the Environment, and Janneke Ratcliffe, UNC, Center for Community Capital*

NCIF Social Performance Metrics: Increasing Flow of Investments in Distressed Neighborhoods through Community Development Banking Institutions

*Saurabh Narain and Joe Schmidt, National Community Investment Fund*

## Commentary

Reject the Reset! *Jed Emerson, Uhuru Capital Management*

Rethink Charity *Dan Pallotta, Pallotta TeamWorks*

Local Stock Exchanges and National Stimulus *Michael Shuman, Business Alliance for Local Living Economies*

At the Crossroads Where Economic Development, Job Creation and Workforce Development Intersect *Carla I. Javits, REDF*

Value *Penelope Douglas, Pacific Community Ventures*

Could "Small Is Beautiful" Replace "Too Big to Fail?" *Don Shaffer, RSF Social Finance*

FEDERAL RESERVE BANK OF SAN FRANCISCO



## Community Development INVESTMENT REVIEW

The Community Affairs Department of the Federal Reserve Bank of San Francisco created the Center for Community Development Investments to research and disseminate best practices in providing capital to low- and moderate-income communities. Part of this mission is accomplished by publishing the *Community Development Investment Review*. The *Review* brings together experts to write about various community development investment topics including:

**Finance**—new tools, techniques, or approaches that increase the volume, lower the cost, lower the risk, or in any way make investments in low-income communities more attractive;

**Collaborations**—ways in which different groups can pool resources and expertise to address the capital needs of low-income communities;

**Public Policy**—analysis of how government and public policy influence community development finance options;

**Best Practices**—showcase innovative projects, people, or institutions that are improving the investment opportunities in low-income areas.

The goal of the *Review* is to bridge the gap between theory and practice and to enlist as many viewpoints as possible—government, nonprofits, financial institutions, and beneficiaries. As a leading economist in the community development field describes it, the *Review* provides “ideas for people who get things done.” For submission guidelines and themes of upcoming issues, visit our website: [www.frbsf.org/cdinvestments](http://www.frbsf.org/cdinvestments). You may also contact David Erickson, Federal Reserve Bank of San Francisco, 101 Market Street, Mailstop 215, San Francisco, California, 94105-1530. (415) 974-3467, [David.Erickson@sf.frb.org](mailto:David.Erickson@sf.frb.org).

Center for Community Development Investments  
Federal Reserve Bank of San Francisco  
[www.frbsf.org/cdinvestments](http://www.frbsf.org/cdinvestments)

### Center Staff

**Joy Hoffmann**, FRBSF Group Vice President

**Scott Turner**, Vice President

**John Olson**, Senior Advisor

**David Erickson**, Center Manager

**Ian Galloway**, Investment Associate

### Advisory Committee

**Frank Altman**, Community Reinvestment Fund

**Jim Carr**, National Community Reinvestment Coalition

**Prabal Chakrabarti**, Federal Reserve Bank of Boston

**Catherine Dolan**, Wachovia Community Development Finance

**Andrew Kelman**, Bank of America Securities

**Judd Levy**, New York State Housing Finance Agency

**John Moon**, Federal Reserve Board of Governors

**Kirsten Moy**, Aspen Institute

**Mark Pinsky**, Opportunity Finance Network

**John Quigley**, University of California, Berkeley

**Benson Roberts**, LISC

**Ruth Salzman**, Ruth Salzman Consulting

**Ellen Seidman**, ShoreBank Corporation and  
New America Foundation

**Bob Taylor**, Wells Fargo CDC

**Kerwin Tesdell**, Community Development Venture  
Capital Alliance



# Table of Contents

## Articles

Mission Insurance: How to Structure a Social Enterprise So Its Social And Environmental Goals Survive Into the Future .....	1
--	---

*Kevin Jones, Good Capital*

Exploring the Continuum of Social and Financial Returns: When Does a Nonprofit Become a Social Enterprise? .....	7
---	---

*Kathy Brozek*

Using High-Transparency Banks to Reconnect Money and Meaning.....	18
---	----

*Bruce Caban*

Impact Investing: Harnessing Capital Markets to Solve Problems at Scale .....	30
---	----

*Antony Bugg-Levine, Rockefeller Foundation, and  
John Goldstein, Imprint Capital Advisors*

Increasing Access to Capital: Could Better Measurement of Social and Environmental Outcomes Entice More Institutional Investment Capital into Underserved Communities? .....	43
--	----

*Lisa A. Hagerman , College Institute for Responsible Investment, Oxford University Centre for the  
Environment, and Janneke Ratcliffe, UNC, Center for Community Capital*

NCIF Social Performance Metrics: Increasing Flow of Investments in Distressed Neighborhoods through Community Development Banking Institutions .....	65
---	----

*Saurabh Narain and Joe Schmidt, National Community Investment Fund*

# Table of Contents

## Commentary

Reject the Reset!.....	76
<i>Jed Emerson, Uburu Capital Management</i>	
Rethink Charity.....	79
<i>Dan Pallotta, Pallota Team Works</i>	
Local Stock Exchanges and National Stimulus.....	81
<i>Michael Shuman, Business Alliance for Local Living Economies</i>	
At the Crossroads Where Economic Development, Job Creation and Workforce Development Intersect .....	85
<i>Carla I. Javits, REDF</i>	
Value .....	88
<i>Penelope Douglas, Pacific Community Ventures</i>	
Could “Small Is Beautiful” Replace “Too Big to Fail?” .....	92
<i>Don Shaffer, RSF Social Finance</i>	

# Foreword

David Erickson

*Federal Reserve Bank of San Francisco*

*August 2009*

In Karl Polanyi's seminal work, *The Great Transformation*, he argues that it was a radical departure for Western society in the early modern period to divorce land, labor, and capital from their traditional values, turning them into commodities that could be bought and sold.

The crucial point is this: labor, land, and money are essential elements of industry; they also must be organized in markets; in fact these markets form an absolutely vital part of the economic system. But labor, land, and money are obviously not commodities....Labor is only another name for human activity which goes with life itself, which in its turn is not produced for sale for entirely different reasons, nor can that activity be detached from the rest of life, be stored or mobilized; land is only another name for nature, which is not produced by man; actual money, finally, is merely a token of purchasing power which, as a rule, is not produced at all, but comes into being through the mechanism of banking or state finance. None of them is produced for sale. The commodity description of labor, land, and money is entirely fictitious.<sup>1</sup>

Not long ago in Europe, and still in many places in the world today, traditional and community values reigned. In those circumstances, laborers did not measure their time by the hour and sell it to an employer, there were no real estate sales offices in the village center, and capital had yet to accumulate. (If Marx was right and capital was frozen labor, then the world still needed the nation-state and a modern financial system to play the role of the freezer.)

We may be on the edge of another period when we reintroduce community values to the commodities of land, labor, and capital. In this issue of the *Review*, we explore how both business enterprises and investment decisions can be infused with community goals—providing for those who are less capable of providing for themselves, promoting better health and stronger community fabric, and respecting the environment. Community development finance is already playing a supporting role in this evolution.

Kathy Brozek kicks off this issue and gives an overview of social enterprise, providing a context and tools for understanding the entire spectrum of business enterprises—from purely profit-motivated on one end, to purely charity on the other. Kevin Jones also explores social enterprises, particularly in terms of how their social missions can survive all stages of growth, even an initial public offering.

---

1 Karl Polanyi, *The Great Transformation: The Political and Economic Origins of Our Time* (Boston: Beacon Press, 1944), 72.

Antony Bugg-Levine and John Goldstein provide an overview for what they term “impact investing,” with an eye to how public policy, CRA-motivated banks, and individuals might promote this category of investment. Lisa Hagerman and Janneke Ratcliffe explore how we might better measure progress on community values in a given investment; sophisticated financial tools help measure profit, but these authors explore how to measure, in a meaningful and standardized way, the social and environmental good that comes from the investment. Saurabh Narain is also interested in measuring social and environmental outcomes and specifically shows how intermediaries—community banks and community development financial institutions—can provide the bridge from the world of global capital to the neighborhoods of need. Bruce Cahan also explores how a mission-oriented bank can be a useful intermediary between socially motivated savers and consumers and the larger economy.

Finally, our commentary section features a lively debate among leading thinkers in the field of social enterprise and impact investing, including Jed Emerson, Dan Pallota, Michael Shuman, Don Schaffer, Penelope Douglas, and Carla Javitz.

After the near collapse of the world financial system, it is time to reflect on whether social enterprise and investing might not offer some lessons for creating a more sustainable economy.

A handwritten signature in black ink, reading "David Emerson". The signature is written in a cursive, flowing style with a prominent initial "D".

## Mission Insurance:

How to Structure a Social Enterprise So Its Social  
and Environmental Goals Survive Into the Future

*Kevin Jones*

*Good Capital*

**C**an a business's social mission survive when a profitable social enterprise sells to a multinational? The twin stories of Ben & Jerry's and Better World Books stand as bookends in the answer to this question. Ben & Jerry's is the common story: selling means selling out. Better World Books has a different ending.

By linking its social mission to a lower cost of goods, deep brand value, and even capitalization and ownership structure, Better World Books may have built a business in which the mission can survive the exit.

But first, the story with the traditional ending. Hidden inside four Ben & Jerry's stores in San Francisco in the late 1990s was a secret social mission. The tourists buying a scoop of Chunky Monkey on the corner of Haight and Ashbury and the young hip investment bankers carrying early Blackberry's in the Marina neighborhood had no idea their ice cream was being scooped by young men who had been on the edge of gangs from the Hunter's Point ghetto.

Sure there was a chance that customers liked the fact that nearly one-half of the employees were enrolled in a comprehensive social service program that included tutoring for their high school equivalency certificate and how to handle a savings account. However, there was a greater risk that if the customer thought the shop was bringing them into contact with ghetto kids with a past, they might go elsewhere, cutting into sales and jeopardizing the subsidized social service programs.

Ben & Jerry's customers liked that the company had taken an ethical stand by saying no to using milk infused with bovine growth hormone. The company's environmental virtue had created such brand value that it was highlighted on the ice cream cartons, along with its clever descriptions of the mix of flavors and syrups and cookie dough. That approach differentiated the company from other high-end competitors such as Häagen Dasz, creating financial value the company eventually realized when it sold to Unilever. However, the social virtue—the workforce development program that involved 40 percent of the employees in a shop and 30 percent of those selling the ice cream at the 49'ers and Giants games—was kept hidden.

Ben Cohen, in an act of private charity and good will, had allowed Juma Ventures and other high-performing nonprofits to pay a reduced franchise fee, essentially subsidizing the social mission. That reduced fee, the profits from the shop itself, along with grants from the few foundations that believed in a market-based approach to accomplishing a social mission, enabled Juma Ventures to provide more extensive social services than it could have by relying on philanthropy alone.

School, saving, and work all combined to help the young people see a path out that they might otherwise have missed. More lives were changed by embedding a social service program within a business that could cover much of the program's costs.

Then Ben & Jerry's sold to Unilever and things changed, as they always do when founders hand things over to a public company. Some important things were lost and some survived. Ours is not a story of villainy, but of profit and loss practicality. The multinational realized that, thanks to clever messaging, affluent consumers were buying the environmental mission of the company. It was a value that showed up on the bottom line; the ice cream gets a premium for its stance on environmental sustainability.

Within months, however, the nonprofit franchise discovered that life had changed. They were vulnerable because keeping the social mission a secret was one key to its success.

The social mission, unlike the environmental mission, created no brand value, no halo around the product. It made no financial sense for Unilever to continue to offer reduced fees and terms to the nonprofit franchise shops. It was a cost with no accompanying financial benefit. Under Ben Cohen's leadership, Juma Ventures and other franchises had been called nonprofit partner shops. They were now discontinued.

Selling often means selling out and selling certain key piece of value the founder holds dear. That's the typical story. It is not a new story, and that is part of the problem. We need a new story, and I think the market and consumer behavior and the realities of what value means to investors may allow a new story to be written. Maybe.

As one of the founders of a venture fund promising our investors a mix of financial and social return, I want to create a new narrative, one in which the social mission survives the sale to a big company, where the numbers rule all and there is no founder to decide to compromise some portion of the profits by either subsidizing a social mission or going after lower-income customers.

After being involved in the social capital market for nearly nine years as a member of various industry and association boards, and as an investor and advisor to social enterprises, and having spent eight months doing a comprehensive survey of the landscape of social enterprise, I believed I had learned a few things when we launched Good Capital a couple of years ago, an investment firm that increases the flow of capital to innovative ventures creating market-based solutions to inequality and poverty.

The first thing that became clear was that it was possible to build a large, profitable business with a social mission at its core. It was also possible to use the market and its efficient allocation of human, financial and cultural resources to deliver greater social impact at greater scale than via philanthropy alone.

Although the market alone does not produce the scalable social impact (it does it in concert with philanthropy and public resources), the market is an additive factor. Microfinance, now a valid asset class with major investment banks selling its bond and derivative products, would not have become successful without visionary nonprofits. These nonprofits pioneered in lending to groups of women in rural villages when others scoffed at the idea that



the poor could lift themselves out of poverty with anything other than a gift from “the haves.”

It is the same with the new generation of for-profit and nonprofit social enterprises, businesses created to combat poverty and injustice via the market. Often these companies are partners with grant-funded nonprofit organizations that have paid for the infrastructure that enables the social impact, such as governments that build highways that enable privately owned trucks to haul freight. But the market is a mechanism that can bring things to scale, that can let an enterprise grow at low cost through an efficient use of resources. Philanthropy is not built to take a particular enterprise to scale, and public expenditures take far longer to deploy and are less flexible and responsive to on-the-ground conditions.

The second thing that became clear when we launched the social enterprise expansion fund at Good Capital was that the social mission (unlike an environmental mission, which can often create additive brand value that results in higher margin) often gets stripped out after sale. Selling turns into selling out. No one in the new generation of social purpose businesses wants to replicate Ben & Jerry’s experience.

As a six-time successful serial entrepreneur with nothing left to prove and little left to win in traditional business, I believed I could help young businesses grow. I teamed with Tim Freundlich, my partner at Good Capital, who was one of the leading financial innovators in social investing. Freundlich was the architect of the Calvert Community Investment Note, which grew from zero to \$160 million in assets and enabled retail investors to put their money into a microfinance institution in Ecuador or a fair trade co-op in Africa. Our third partner, Joy Anderson, brought deep experience in nonprofits and a knack for working with large organizations around big issues. We saw a crying need for risk capital to help these social-purpose businesses take advantage of the market and social needs they were uniquely suited to fulfill.

We have raised a few million dollars from some visionary investors who are capable of standing in that new middle ground between giving and investing, who can feel the right-brain, heart-tugging need to have a big impact on the pressing problems of poverty and injustice. These investors are able to let that right brain converse with the rigorous, analytical left brain financial assessment that enables good investment decisions, and to choose a business on its financial merits.

We had no doubt we could find good businesses to invest in, businesses with solid social missions baked into their DNA. That had already been proved, sometimes by owners like Ben Cohen. What had not been proved, and what has yet to be proved, is whether one can build a business in which the social mission survives the exit. How do you sell and have some reasonable faith that you are not selling out? That is the question that Good Capital has set about trying to answer.

In the work we have done with our first portfolio company, Better World Books, we think we have come up with some innovations that may stand the test of time.<sup>1</sup> An online book-

---

1 <http://www.betterworldbooks.com/>

seller has grown from \$18 million in revenue when we invested in late April 2008 to \$30 million in annual revenue by June 2009. It has been operating with positive cash flow every month in 2009. Better World also has a unique, philanthropically dependent supply chain.

People give the company its core product. Better World Books receives more than six million books a year from used textbook donation drives on campuses. These drives benefit nonprofit literacy groups such as Books for Africa and Room to Read. This source reduces the company's cost of goods by around 7 percent on a gross profit basis. That is the amount it remits to the literacy nonprofits after selling the donated books online. In the first four years, the literacy nonprofits received more than \$5 million in cash from sales of donated books. In addition, the company sells online hundreds of thousands of books and donates others to literacy groups, mostly from libraries clearing out their shelves.

The libraries win, too. In 2008, the Brooklyn Library received more than \$90,000 in exchange for books that would have been trashed or recycled. The money was unrestricted income, the hardest money to come by. Unrestricted funds cover gaps in payroll or operations. In contrast, funders who think they know better than librarians how their money should be spent offer restricted funds that must be devoted to a particular program. Better World Books delivered another \$40,000 to the Brooklyn Library, which the library gave to a local literacy group, Brooklyn Reads.

The waste stream, books headed for the trash, are converted to revenue in more than 1,000 libraries, which are now better able to keep their doors open and their reference desks staffed in the midst of budget cuts during the downturn. Along the way, Better World Books saves hundreds of thousands of pounds of books from the landfill every year. It also adds a small surcharge to buy carbon offsets so that its books ship to consumers as carbon neutral.

Better World Books is branding its environmental impact—that items destined for the trash are being reused. Every used book sold eliminates the environmental cost of chopping down trees and manufacturing a new book. Also core to the story is that the business was built as a method of funding literacy efforts at greater scale than philanthropy alone could manage. Like Ben & Jerry's, it is branding its environmental value. Unlike Ben & Jerry's, it is also branding its social value on campuses across the country. Students sell their books to Better World Books rather than to the bookstore because they trust the company and they want to help promote literacy. Its social mission is part of what people are “buying” when they give the company the books that Better World turns around and sells.

That viral, scalable dynamic has created a fast-growing rocket ship of a business. Because the social value is creating brand value and affinity with students who also become more likely to buy books from Better World, it is more likely to survive a sale to a multinational after the company crosses \$100 million.

The social mission's brand value, the trust that causes students to give the company its product, also results in a lower cost of goods. That is another reason the mission is likely to survive an exit. A multinational that strips out the link to the literacy nonprofits could

create higher costs of operation and gut the core brand value of the company with its key customer base. The social value is similar to Ben & Jerry's continuing refusal to use milk infused with bovine growth hormone even after the sale to Unilever; it is a value that makes business sense.

Lower costs and higher margins are joined at the hip with high social impact just as they were at Ben & Jerry's. However, Better World Books is avoiding the pitfall of hiding the social mission. Instead, it is creating brand value with its social mission. We've helped Better World build a business in which the mission is more likely to survive an exit. But we've also done something even more unusual. We've created a capitalization structure that will make the nonprofits key players at the table if and when an eventual sale occurs. That's the real secret sauce inside Better World. We created a reverse poison pill that can keep the social mission intact at sale and then we swallowed it.

Let me explain. When we were first negotiating our investment term sheet with Better World, the founders had no money from investors despite racing to \$18 million in revenues in four years. They were so focused on their mission that they proposed giving one-half of their profits to the literacy nonprofits, which scared away other investors. We pointed out to them that such a plan would cut the valuation of the company in half, and result in only half the money they needed to grow. Instead, we suggested they put aside 5% of their founders' stock into an option pool dedicated to their nonprofit partners. Let Books for Africa and Room to Read vest their options on two metrics; how they performed on their social mission and how many books they brought in.

With vested stock options, the nonprofit would be a beneficial shareholder at the time of sale, and their interests would have to be accounted for. The company agreed, and we helped them change the capitalization table to incorporate the nonprofit literacy partner stock option plan.

For Good Capital, we call this kind of structure "mission insurance," and it is the kind of thing we look for or try to create. Our goal is not just to show that a social-purpose business can grow, but to prove that the social mission can survive the sale to a profit-driven multinational. Together with Better World Books we have augmented its intrinsic mission insurance at three levels; cost reduction, brand value, and ownership.

By putting a price on literacy and measuring its growth, we have made the mission impact one of the assets of the company. It will be part of what an acquirer buys, not a hidden pocket of philanthropy tucked away in a portion of the company destined to be swept aside when the number crunching multinational send in its cost cutting teams.

As it happens, literacy is particularly easy to measure; every good teacher does it for every student, judging how far the student has progressed on vocabulary, syntax, and so forth. Rather than derive our own cumbersome measure of social impact, we've simply incorporated the metrics that the nonprofits already report to their own foundation funders. The cost of measurement is already being born by the nonprofits, and the foundations and educational institutions have validated those metrics over the years.

We have just set up a structure in which the literacy nonprofits can anticipate a big payday that can have a huge impact on their organizations if the company succeeds. If we have built in the right levers, Better World Books will not be yet another cash-out and a sellout. For Better World, the social and environmental mission is core to the brand and a key to a low-cost supply chain that in itself builds customer loyalty. That value will be clear to the right acquirer.

The mission is part of the brand, but the people in charge of delivering on the mission, the nonprofit literacy organizations, are also owners of the company, shareholders with rights. Having the nonprofits represented in a sale, or at least with their interests represented, will help ensure that message is not drowned out when the numbers get big and people start seeing dollar signs in the air. Increasing literacy is equated with an increasing value of stock options.

Like every other venture investor, we look for barriers to entry by competitors when evaluating a prospective investment. But our real goal is to link those competitive advantages with a parallel set of barriers to mission exit.

We look for elements in the way the company operates, in the way it builds its brand, and sometimes in creative and transformed ownership structures that embed the mission so deeply into the company that it costs the acquirer money to run the business and damages customer relationships if the mission is removed. To make the point clear, at Better World, we created a seat at the table (the exit table) for those delivering the mission and established a structure in which the social impact becomes an asset of the company. Removing the mission results in higher operating costs, lower margin, brand erosion, and a complicated sale.

Will the mission survive the eventual exit at Better World Books if it sells at the \$100 million point? Time will tell. On the other hand, a sale is not the only option. If Better World Books decides not to sell, and decides to continue operating as a fast-growing, profitable business, we have installed a put option that will let the company buy out our interests and deliver our investors a return based on a valuation of 1.5 times revenue at a fixed point in the future. The company is on a trajectory that would give our investors a very solid double-digit return if it stays on track. It is doing well. It is doing good. And it is built to keep doing that, no matter what happens in the future.

*Kevin Jones is a serial entrepreneur, seven of whose eight businesses achieved market dominance. He has been a columnist for Forbes, and early in his career his reporting put a Mississippi sheriff in prison. He is excited to see the social capital market come together.*

# Exploring the Continuum of Social and Financial Returns:

When Does a Nonprofit Become a Social Enterprise?

*Kathy O. Brozek*

Goodwill Industries and the YMCA have something in common: by most definitions they each would be considered a “social enterprise,” a relatively new and increasingly popular term in the United States. Yet both these nonprofit organizations have a history dating back more than 100 years. For Goodwill Industries of San Francisco, which serves three counties in the San Francisco Bay Area, a whopping 89 percent of its \$28 million revenue for fiscal year ending June 2008 came from its business enterprises, not from government grants or foundations. By any standard, this is an enviable nonprofit revenue stream. Goodwill provides training, life coaching and jobs for those who possess a track record considered too risky for the private and public sector employment.<sup>1</sup>

In 2005, 54 percent of all U.S.-based nonprofit revenue, excluding that from hospitals and universities, was generated from the fees for goods and services. (Fees include government payments for services, but are not grants).<sup>2</sup> Yet even though fees account for more than one-half of the sector’s total revenue, nonprofits with social enterprise models like Goodwill Industries are not pervasive. Rather, the fee income of most nonprofits is not integral to its operational model and supplements other, more substantial, funding sources.

The differences between a nonprofit with earned income and a social enterprise nonprofit are core to this discussion and go beyond semantics and nuance. I posit that these distinctions lie in organizational structure, funding sources, formation, employees, founders, execution of tactics, and other parameters. I am not advocating one model over the other, but instead will focus on the challenges, opportunities, and trends facing nonprofits and the circumstances in which each model is a better fit. With insight, stakeholders can create the sustainable and innovative nonprofit organizations that this resource-strapped sector so desperately needs.

In general, all nonprofit and for-profit organizations fall along a continuum from social to financial returns. Effecting social change by combining in one organization social and financial returns, also referred to as blended value, is a key component of the evolving social capital market.<sup>3</sup> Figure 1 captures the essence, and the inherent ambiguity, of the social enterprise model.

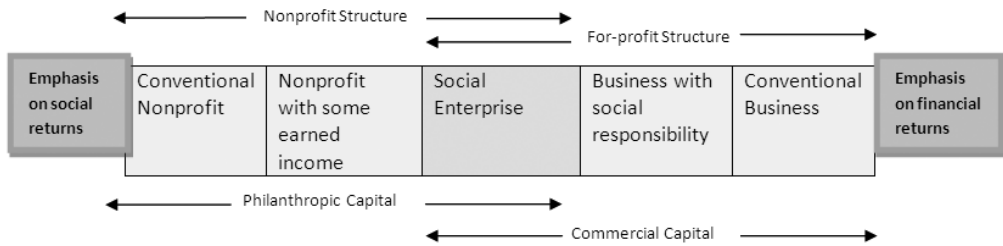
---

<sup>1</sup> Goodwill Industries of San Francisco, San Mateo and Marin Counties 2007-2008 Annual Report (990 tax return) (San Francisco: Goodwill Industries, 2008).

<sup>2</sup> Urban Institute, *Nonprofit Almanac 2008* (Washington, DC: Urban Institute Press, 2008), p. 145, figure 5.3.

<sup>3</sup> See Jed Emerson and Sheila Bonini, *The Blended Value Map: Tracking the Intersects and Opportunities of Economic, Social and Environmental Value Creation* (Blendedvalue.org website, February 24, 2004), available at [www.blendedvalue.org/publications/](http://www.blendedvalue.org/publications/).

*Figure 1. Spectrum of Social and Financial Returns*



*Source: Stanford Social Innovation Review, Spring 2008; Jed Emerson cited as a contributor*

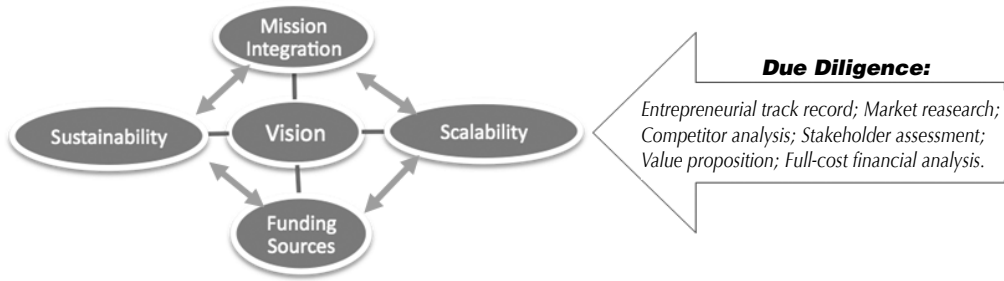
Presently there is no universally accepted definition of “social enterprise” for either a for-profit or nonprofit organization. The Social Enterprise Alliance defines social enterprise as “an organization or venture that achieves its primary social or environmental mission using business methods.” According to the Blended Value organization, a social enterprise is a “nonprofit organization that uses business solutions to accomplish social goals; the social objective is the primary driver.”<sup>4</sup> Here, I define social enterprise as a nonprofit organization with a sustainable, scalable revenue stream generated from activities related to its social mission; it has an entrepreneurial operating model and leadership team.

Another example of a social enterprise is the entrepreneurial and financially sustainable Delancey Street Foundation, a 501(c)(3) nonprofit. Despite many naysayers, in 1971 a few visionaries decided to help the unemployable—former drug addicts, people living on the street, and ex-felons—to turn their lives around through vocational training and entrepreneurial endeavors by “empowering the people with the problem to become the solution.” To this day, they continue to use this self-help model to run twelve social enterprises in five locations across the country, all without any government funding.

Where a nonprofit lands on the continuum of social and financial returns is determined by the vision of the leadership, its executive director and/or the board. However, this decision is, or should be, a dynamic process, as depicted in Figure 2. The vision is influenced by a core belief about how to address a social issue and a pragmatic assessment of how best to achieve the mission. For a nonprofit social enterprise, the question is whether the social mission can be integrated into a scalable, profitable, fee-based model with ongoing financial sustainability. The answers are not always clear-cut, and the risks often hard to quantify. Ideally, it would be an iterative decision process with a due diligence rigor similar to what a company would undertake in its early stages.

<sup>4</sup> Social Enterprise Alliance is at [www.se-alliance.org](http://www.se-alliance.org); E. Bibb, M. Fishberg, J. Harold, and E. Layburn, “Blended Value Glossary” (Blended Value, July 2004), available at [www.blendedvalue.org/publications/](http://www.blendedvalue.org/publications/).

Figure 2. Assessing the Nonprofit Models



The first question in locating an organization’s place on the continuum is whether a fee revenue model of any type is embedded in the operations; is it likely, in other words, to generate a timely, profitable cash flow? Questions to ask include: Is the infrastructure (staff, accounting, IT systems, building space, etc.) in place or does it need to be acquired? Will the revenue model detract from accomplishing the organization’s mission? Does staff have the necessary business acumen? Are the financial projections realistic?

If the answers point to relying strictly on outside funding, the organization lands far left on the continuum. Otherwise, whether it is a small, contained revenue stream or a full-fledged nonprofit social enterprise depends on the following criteria (see also Figure 2):

- A social mission integrated into a revenue model: Will this better serve the constituents? Does the operations model involve a workforce development strategy? If necessary, is the market willing to pay a price premium for a “socially responsible” service or product? What are the tax implications of not having the social mission integrated in the model?<sup>5</sup>
- Scalability: Is there capacity to increase revenues each year? Can the business model be easily replicated? Is growing the model feasible on the basis of funding, marketplace, staff, systems, etc.?
- Sources of funding: Is it a multiyear funding commitment or series of one-year grants and ongoing fundraising? Do the funders provide a collaborative coaching process? Without a fee-generating revenue stream, are other sources of funding available?
- Sustainability: To what extent will the fee revenue add to the future sustainability of the nonprofit? What is the ongoing risk of losing money? Will it detract from the social mission over time?<sup>6</sup>

5 Anthony Mancuso, *How to Form a Nonprofit Corporation* (Berkeley, CA: Nolo, July 2007), pp. 80-81.

6 Alex Nichols, ed., *Social Entrepreneurship: New Models of Sustainable Change* (New York: Oxford University Press, 2008), pp. 205-206.

New Door Ventures, a nonprofit social enterprise based in San Francisco ([www.ggci.org](http://www.ggci.org)), is a good illustration of the concepts just described. Its revenue-generating model includes a social mission to provide assistance to at-risk youth aged 14 to 21. It offers hands-on training, internships, community support, and jobs programs at its small business ventures. In 2007, its business operations generated nearly 60 percent of its revenue. Its ventures include Pedal Revolution, a bicycle retail, repair, and custom-design shop, and Ashbury Images, a graphic arts production business. They continually seek new ventures. New Door Ventures was part of the REDF venture philanthropy portfolio from 1991 through 2005, receiving funding, coaching, and other benefits. The New Door Ventures social enterprise model works, not by accident, but because of its clear vision, operational efficiency, and innovation, which it has maintained throughout its lifecycle with the help of its initial funder, REDF.

Exploring the distinguishing characteristics between the two models—a nonprofit that generates some income and a social enterprise—highlights the influences that position nonprofits on the continuum and whether the revenue model evolved from an organic process or as a defensive reaction to a challenging environment. Certain features, by definition, describe a nonprofit social enterprise but appear less frequently in nonprofits with earned income. These features include an entrepreneurial vision of the executive director and/or board; a social mission integrated into the fee revenue model; a fee revenue model at the nonprofit’s inception; a scalable operational model; and alliances and resources that are uniquely combined to create value. Additional features include close collaboration and coaching with major funders, a multiyear funding financial commitment, and a workforce development program embedded in the operational model.

Which model is best also depends on the situation. If the operational, financial, and human resources needed for a social enterprise are absent and raising the funds to acquire them is difficult, then a nonprofit with some earned income, even if not scalable, is the prudent choice. A fee revenue stream of any type can enhance the prospect of receiving funding. A Harvard Business Review article offered an example of a model that, in the end, was dysfunctional and stands in contrast to the New Door Ventures story. The author cites an unnamed nonprofit that built an industrial-sized kitchen to earn income through its catering and wholesale operations while providing job training to an underserved market. The kitchen was experiencing yearly losses exceeding \$250,000 and few were getting jobs, but the grant-making foundations were excited about the concept; it served as a reliable fundraising tool so the operations were maintained.<sup>7</sup>

This may be an extreme example of a funding system gone awry, but in the rush to generate more income, nonprofits are often pushed to eke out revenues however they can. It also underscores the question that arises in this process of how to assess the ability to raise

---

7 William Foster and Jeffrey Bradach, “Should Nonprofits Seek Profits?” Harvard Business Review vol 83 (2) (February 2005): 92-100.



external funding. If a nonprofit possesses marketing savvy when seeking outside funding but bypasses the necessary due diligence to build a profitable model with good leadership, it could turn into an inefficient, money-losing venture. Or, it could mistakenly be perceived as successful because of incorrect accounting methods. The Harvard Business Review article mentioned above challenged the results of research studies conducted by two reputable organizations that indicated a fairly high rate of profitability among nonprofits with earned income. The authors substantiated their claim by sharing research findings from their own, presumably less biased, study. I will not attempt to refute the authors' analysis, but it is noteworthy as it highlights the complexities of defining and measuring success on the "blended value" continuum, which in turn, may muddle the decision process.

Moving right on the continuum in Figure 1, for-profit entrepreneurs that have incorporated a social mission into their model often face a trade-off between social and financial returns. Figure 2 still applies but the driver is the desire for a higher return which, at least in theory, means lower social returns. Increasingly, indications are that this gap may be shrinking, albeit slowly. Consider Revolution Foods ([www.revfoods.com](http://www.revfoods.com)), a start-up company that provides nutritionally healthy and mostly organic food for public schools in California and also sells its products retail. Their objective is to generate market returns while tackling the issues of childhood obesity and healthful food in public schools.

One of the changes that is helping to close the gap between the social and financial return are new investors such as DBL Investors, that invested in Revolution Foods. DBL is a venture capital firm with a mission to assist its portfolio companies in implementing a "double bottom line" strategy. The Community Reinvestment Act (CRA) is also influencing the funding on the for-profit end of the blended value continuum. Banks are able to fulfill their CRA requirements by providing loans to businesses in underserved markets, and more recently, by investing in social-mission-driven venture capital firms such as DBL Investors. Finally, other individual investors are starting to seek out social-mission-driven businesses with the expectation that they produce full market returns. The blended value continuum in Figure 1 will realign over time if public policy continues to incent private investment in social-mission-driven businesses.

## **Nonprofit Sector: Market Size and Funding Sources**

The efficacy of the nonprofit sector funding process has been a topic filled with some consternation. Bill Drayton, the founder of Ashoka, stated, "What a social entrepreneur needs and what a foundation provides is an almost perfect mismatch."<sup>8</sup> George Overholser, founder of NFF Capital Partners, has argued that the dearth of "builder" capital, which helps to sustain growth by investing in infrastructure, has a negative effect on the nonprofit sector. In contrast, "buyer" funding, which in effect purchases services for more recipients, is

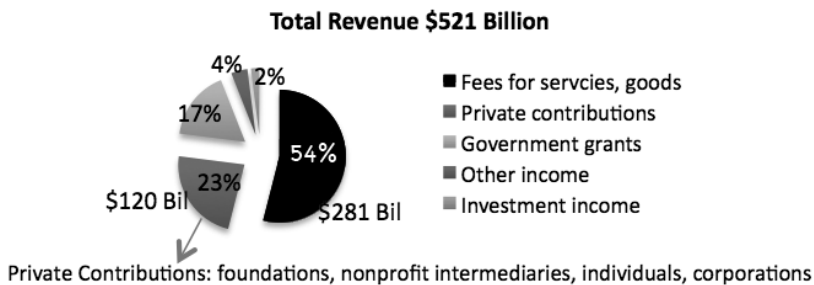
---

8 Nichols, *Social Entrepreneurship*, p. 309.

easier to obtain but often includes restrictions.<sup>9</sup> A report from the William and Flora Hewlett Foundation describes how the information gap in philanthropy, both for foundations and individual donors, results in inefficient distribution of funding.<sup>10</sup> Other practitioners attribute the challenges that social enterprises face in raising funds to their unconventional place on the continuum.<sup>11</sup>

Of the 1.4 million nonprofit organizations registered with the IRS, the vast majority were 501(c)(3) public charities. The IRS requires only those with more than \$25,000 in gross receipts to file reports; religious congregations, foreign, and government-associated organizations are exempt. In 2005, approximately 303,500 reporting public charities (excluding hospitals and universities) generated \$521 billion in revenue.<sup>12</sup> As noted, the majority of revenue, 54 percent, comes from the exchange of goods and services (see Figure 3). Of this, about one-fifth of the total is government fees (not grants) for services.<sup>13</sup>

Figure 3. Sources of Revenue for the 303,500 IRS-Reporting Public Charities\* for 2005



Source: *The Nonprofit Almanac 2008*

\* excludes hospitals, universities

The next largest source of funding is private contributions, totaling about \$120 billion, or 23 percent. Private contributions are from individuals, foundations, corporations, and nonprofit intermediaries. Of the 23 percent, individuals contribute approximately 16 percent and foundations, 5 percent (see Table 1).<sup>14</sup> A significant portion of U.S. foundation giving is in the form of grants to hospitals, universities, and foreign-based recipients, which are

9 George Overholser, “Nonprofit Growth Capital, Part 1: Building is Not Buying” (New York: Nonprofit Finance Fund, n.d.), available at [www.nonprofitfinancefund.org/details.php?autoID=86](http://www.nonprofitfinancefund.org/details.php?autoID=86).

10 William and Flora Hewlett Foundation, “The Nonprofit Marketplace: Bridging the Information Gap in Philanthropy” (New York: McKinsey and Co., 2008).

11 Michael Chertok, Jeff Hamaoui, and Eliot Jamison, “The Funding Gap,” *Stanford Social Innovation Review* (Spring 2008).

12 Urban Institute, *Nonprofit Almanac 2008* (Washington, DC: Urban Institute Press, 2008), p. 149, 153, Tables 5.6, 5.7.

13 “Preliminary Revisions for 2005 from the National Center for Charitable Statistics” (Washington DC: Urban Institute).

14 *Ibid.* Revenue from individuals is estimated from available data.

excluded in Figure 3. For example, only 30 percent, or \$467 million, of the ten largest U.S. foundation grants in 2005 were for nonprofits as defined in this analysis.<sup>15</sup>

*Table 1. Sources of Private Contributions for Public Charity Revenue\**

	Nonprofit Intermediaries	Foundations	Individuals	Corporations
Percentage of total public charity revenue	Less than 1%	5%	16%	Less than 2%
Who funds?	Individuals, foundations, corporations, banks, government	Individuals, corporations	Self	Self

*Sources: Urban Institute, Nonprofit Almanac 2008; Ford Foundation estimate of 5% - Preliminary revision for 2005 from the National Center for Charitable Statistics at the Urban Institute; Other percentages based on author's calculations; Giving USA Foundation*

*\*Excludes hospitals and universities.*

Two of the groups comprising private contributions—intermediary investors and foundations—are detailed in Chart 1. Intermediary investors are nonprofit organizations that invest or donate money from other sources; they disburse funds using well-defined objectives and criteria.<sup>16</sup> (Foundations are essentially nonprofit intermediaries but are discussed separately for this analysis.)

## Nonprofit Intermediaries

There are three subgroups of nonprofit intermediaries (see Chart 1 ). The first subgroup is “venture philanthropy,” often called high-engagement philanthropy (engagement between the recipient and the funder). The Blended Value glossary defines venture philanthropy as:

*A model for charitable giving that arose in the 1990's, based on the application of the venture capital investment principals. Funds “invest” not just money but energy and expertise in the organizations they support...nonprofits are asked to provide evidence of their results and impact on a regular basis...focuses on leadership, bold ideas, developing strong teams, active board involvement and long-term funding.*

The venture philanthropy model has stirred controversy in some circles owing to perceived clashes in cultures and objectives. It works best for nonprofits with a solid operational model, ambitious goals, a team open to collaboration, and a potential for scalability

<sup>15</sup> “Biggest Grants Announced in 2005,” Chronicle of Philanthropy, January 12, 2006.

<sup>16</sup> Chertok, Hamaoui, and Jamison, “The Funding Gap.”

and sustainability.<sup>17</sup> Venture philanthropists usually limit their focus to a specific issue(s) in a region. Venture Philanthropy Partners, for example, chooses nonprofits that serve disadvantaged children and youth in the Washington, DC area. Full Circle Fund and Tipping Point Community in San Francisco require individual donors to make a minimum contribution and to coach the nonprofits in the portfolio. Tipping Point board members cover the firm's operational expenses, ensuring that all donations go directly to the nonprofits. The model has gained some traction by refining the mix of engaged donors and willing nonprofit recipients. The portfolios run the gamut from conventional to social enterprise nonprofits.

The second subgroup, nonprofit loan funds, provides below-market-rate financing to nonprofits, often those with fee revenue streams but that are not necessarily social enterprises. Paul Carttar and Jed Emerson suggest that a nonprofit with earned income is more likely to use debt since lenders like to see a dependable revenue stream.<sup>18</sup> Most fall into the category of Community Development Financial Institutions (CDFI), which are entities established to provide credit and financial services to underserved markets or populations; they are certified by the CDFI Fund, and funded in part by the U.S. Treasury. According to the CDFI Fund website, development projects such as affordable housing are often the recipient of the funds; others target nonprofit organizations. Nonprofit Finance Fund (NFF) lends to nonprofits exclusively; to ensure debt repayment, it typically requires a three-year track record and \$500,000 in operating revenue, and earned income revenue is a plus. RSF Social Finance and Good Capital are two non-CDFIs that are providing a unique blend of financing instruments to both nonprofit and for-profit organizations. Because of the nature of providing debt and repayment, the risks associated with investing in social enterprise nonprofits, particularly in the early stage, do not seem to fit in with this model.

The final subgroup is social entrepreneur funds which focus on finding and financially supporting social entrepreneurs. Ashoka, for example, was founded in 1980 and has been at the forefront of social entrepreneurship in the United States since then. Although there are many definitions of "social entrepreneur," Ashoka uses the following:

*Individuals with innovative solutions to society's most pressing problems. [The social entrepreneur] solves problems by changing the system, spreading the solution, and persuading entire societies to take new leaps.*

The breadth and depth of the social impact that social entrepreneur funds impart distinguishes them from venture philanthropy funds, which focus on key issues within a defined metro area or region. In addition to multiyear grants, some of these funds provide loans for

---

17 Mario Morino and Bill Shore, "High Engagement Philanthropy: A Bridge to a More Effective Social Sector" (Published jointly by Venture Philanthropy Partners and Community Wealth Ventures, June 2004).

18 Paul Carttar and Jed Emerson, "Money Matters: The Structure, Operations, and Challenges of Nonprofit Funding" (Boston: Bridgespan Group, 2003), p. 37.

market-based solutions to systemic social problems, such as the Acumen Fund. An example of an Ashoka-funded entrepreneur is a woman from South Africa's HIV/AIDS-plagued Gauteng province, who developed a home-based nursing service for chronically and terminally ill patients. This program has in turn positively influenced health care policies both in South Africa and globally. In this category, U.S. based nonprofit social enterprises typically are not the primary focus, although a few have been supported.

## Foundations

The second funding source in Chart 1 is foundations; there were more than 72,000 U.S.-based foundations in 2006 and more than 71,000 in 2005.<sup>19</sup> Their grant-making activities have come under much scrutiny during the past decade because of their investment management practices and their grant-making processes. Recent research indicates that grants are often too restricted in use, time-consuming to obtain, and do not offer needed non-financial assistance.<sup>20</sup> (Anecdotally, some attribute the inefficiencies to the “inside circle” of well-connected nonprofits and foundations that can contribute to the increased odds of receiving funding via the grant-application process.) Others discuss an inherent aversion to risk-taking that is fueled, in part, by the foundation boards, staff, and legal and public relations concerns.<sup>21</sup> Consequently, nonprofit social enterprises, particularly start-ups, are at a disadvantage in receiving funding.

In an effort to be more proactive, foundations are increasingly using program related investments (PRIs), which are below-market investments, usually loans made to nonprofit organizations. Receiving a PRI is considered an important step in the nonprofit's financial sustainability, and other lenders perceive it as a sign of the organization's stability.<sup>22</sup> Many PRIs are made to nonprofit intermediaries, that is, CDFIs, which also count as part of the foundation's five percent payout IRS requirement. However, foundations awarded a relatively small number of PRIs in 2005 (428 PRIs totaling \$225 million) relative to the approximate \$26 billion in grants awarded to U.S.-based nonprofit recipients that year (excluding hospitals and universities). In 2007, there were 297 PRIs totaling \$304 million.<sup>23</sup>

Mission-related investing (MRI) “encompasses any investment activity which seeks to generate a positive social or environmental impact in addition to providing a financial

---

19 The Foundation Center, *Highlights of Foundation Yearbook, 2008 Edition* (New York: Foundation Center, n.d.). Urban Institute, *Nonprofit Almanac 2008*, p. 106.

20 “Grant Makers Still Lag in Providing Essential Support, New Reports Find,” *Chronicle of Philanthropy*, December 11, 2008.

21 Nichols, *Social Entrepreneurship*, p. 311.

22 Rockefeller Philanthropy Advisors, “Mission-Related Investing: A Policy and Implementation Guide for Foundation Trustees” (New York: Rockefeller Philanthropy Advisors, 2008), p. 61.

23 The Foundation Center, *database of Program Related Investments for 2005, 2007* (New York: Foundation Center, n.d.).

return.”<sup>24</sup> Technically, PRIs are a component of the MRI portfolio; the purpose is to align the social mission of the organization with its investment policies. Examples of MRI products include Certificates of Deposit in CDFIs, Habitat for Humanity bonds, investments in the Calvert Social Investment Fund, and clean tech venture funds. The investments can fall on the blended value continuum as below-market to market-rate returns. The H.B Heron Foundation is a leader in this field; it justifies its below-market returns because its investments generally help the recipients to attain capital from other sources.<sup>25</sup>

Specialized foundations are slowly emerging as innovators in this arena, focusing on social enterprises and social entrepreneurship. Although few in number, they are garnering much attention as hybrid models of philanthropy. The Skoll Foundation, for example, offers three-year grants for global social entrepreneurs. Draper Richards Foundation provides ongoing coaching to recipients of its three-year awards of \$100,000 annually. The grants, according to their website, are “specifically and solely for entrepreneurs starting new nonprofit organizations.” The reach of the nonprofits must be national or global. The Calvert Foundation funds some social enterprise nonprofits and also, according to its website, offers a Calvert Community Investment (CCI) Note, “a flagship product and most popular offering” where investment is “pooled and placed in a portfolio of affordable loans to over 200 leading nonprofit organizations and social enterprises working in over 100 countries that focus on alleviating poverty.”<sup>26</sup>

## Emerging Trends

Unique combinations of existing models are appearing, such as an integrated franchise-nonprofit model to create a (hopefully) reliable and tested revenue stream. Some established organizations are tweaking their funding models. Ashoka, for example, has begun funding for-profit entrepreneurial organizations as part of their mix. Alliances, such as between Community Good Ventures and Maine Community Foundation, are promoting the efficacy of grants. Community Good Ventures is a consulting group that engages in multiyear coaching relationships with some of the grant recipients of the Maine Community Foundation. In addition, a new legal structure, an L3C, has been formalized in Vermont and Michigan. The L3C is a low-profit, limited liability corporation for social enterprises, providing them with more legal and financial flexibility. Lastly, the Edward M. Kennedy Serve America Act authorizes five-year matching grants to intermediary nonprofit organizations to provide small- and medium-sized nonprofits with organizational development assistance.

---

24 Rockefeller Philanthropy Advisors, “Mission-Related Investing,” p. 11.

25 Ibid., pp. 50, 60.

26 Available at: [http://www.calvertfoundation.org/invest/community\\_investment\\_notes/index.html](http://www.calvertfoundation.org/invest/community_investment_notes/index.html).

## Conclusion

The rate of innovation in the nonprofit sector appears to have accelerated in recent years. Although the new efforts compose a relatively small portion of the sector, they are occurring with greater frequency and have the potential to realign the sector. The nonprofit social enterprise model has been around, amazingly, since the nineteenth century in the United States. As often happens when an industry experiences systemic difficulties, good things that work get repackaged. A system wants equilibrium and in this case, the nonprofit intermediaries and a handful of foundations are leading the way to help make nonprofits of any ilk more efficient and sustainable.

The nonprofit social enterprise warrants distinction from a nonprofit with earned income because of its many-faceted differences, including structure at inception, drivers of sustainability, leadership capabilities and vision, operations model scalability, funding sources, mission integration, and the need for collaboration. At its core, the availability of early-stage funding is the missing link that keeps a promising social enterprise business plan from being implemented. Given that the current funding system favors less risk, shorter time horizons, and labor-intensive practices, this social enterprise model could potentially be underused. Fortunately, the myriad new ideas and structures indicate that the innovative spirit is likely too strong to let the nonprofit social enterprise model fall by the wayside.

*Kathy O. Brozek is a management consultant and writer based in San Francisco working with nonprofits and businesses with a social mission including organizations focused on socially responsible investing. She has held both finance and marketing positions in the financial services industry over several years. Kathy holds degrees from the University of Illinois at Urbana-Champaign and Northwestern University's Kellogg Graduate School of Management.*

# Using High-Transparency Banks to Reconnect Money and Meaning

*Bruce Caban*

High-transparency banking is feasible and emerging. Public-interest accountability metrics can support a new crop of more trustworthy banks, highly-transparent as to their environmental and social impacts and corporate governance practices. To achieve scale, federal banking reform could include special charters and support for high-transparency banks, a new class of banks that develop and make publicly available the open technology standards needed to underwrite, incentivize and exchange transactions that produce positive environmental and social impacts.

Climate change and a frail banking system are both pivotal global crises.<sup>1</sup> So too, their solutions may be linked. Banking traditions, technology, regulatory framework and public trust defined banks in carbon-based economies. Today, banks must evolve to serve sustainable economies. Conditions are ripe for high-transparency banks to emerge.

This article discusses high-transparency banking, its information backbone, the design for one high-transparency bank, and how federal financial regulatory reform could encourage high-transparency banking.

## **Banking as Information Science**

Banks use information to create money - where capital is, who needs to invest it and who needs to borrow and spend it. Information vital to banking includes split-second market prices for borrowed funds, corporate and municipal bond rates, currency and commodity prices and stock markets, as well as information flowing from customer accounts.

Banks access a vast array of data defining us as people, neighborhoods and groups.<sup>2</sup> Through credit reporting agencies and partnerships with government and retail organizations, they build data models predicting the lifestyle patterns of customers.<sup>3</sup> These models let banks tailor everything from access to credit, to the interest rate each customer pays. Banks compete by aiming their data models at customers, targeting their zip codes and affinity groups, to handcraft weekly sales pitches for credit card, mortgage refinance, car loans and other services.

Yet, for all they spend knowing about us, the transparency is one-way. Banks provide meager tools to let customers see the environmental or social impacts of using bank-provided credit or bank-entrusted deposits. The information imbalance keeps customers in the dark so as to grow credit use by disconnecting meaning and money.

---

1 Other pervasive social crises derive from, contribute to or co-exist with these, including deforestation, malnutrition, sanitation, urban sprawl, public health and education.

2 Charles Duhigg, What Does Your Credit-Card Company Know About You? (New York Times May 12, 2009), [http://www.nytimes.com/2009/05/17/magazine/17credit-t.html?\\_r=1&hp](http://www.nytimes.com/2009/05/17/magazine/17credit-t.html?_r=1&hp).

3 For example, Department of Motor Vehicle registrations are mined for prospects that need to buy, maintain or insure a new car or a fleet of cars.



## Banking as Impacts-Opaque Financial Alchemy

As of June 24, 2009, commercial banks in the United States held \$936.5 billion in cash, some 7.8 percent of their total assets.<sup>4</sup> The remaining \$11.1 trillion (92.2 percent) in assets represented claims for payment, either issued by other banks, the government or the private sector, in the form of promissory notes, consumer credit card debt, business borrowing or other forms of secured and unsecured credit. In reality, loans account for nearly all bank assets, and the U.S. dollar is not the primary currency of America: The banking system generates its own trusted forms of “negotiable currency,” nearly all in forms that hide community, environmental and social impact.<sup>5</sup> The banking system assures financial markets can’t price the risks of impacts they don’t see.

## Traditional, “Low-Transparency” Banking

The tools used by bank regulators and in turn the public and media, to oversee bank impacts are coarse, limited mainly to after-the-fact accountancy for financial health. The Federal Financial Institutions Examination Council (FFIEC)’s Uniform Bank Performance Report (UBPR)<sup>6</sup> and the FDIC’s Statistics on Depository Institutions (SDI)<sup>7</sup> provide individual bank financial performance warnings and assurances to regulators, whereby bank peer group benchmarks emerge and timely interventions can be taken.<sup>8</sup> The FFIEC<sup>9</sup> aggregates FDIC-insured banks Community Reinvestment Act (CRA) compliance.<sup>10</sup> Banks and their customers, collateral and investments exist in and share a community’s environmental and social context.<sup>11</sup> CRA is a half measure, spreading credit without measuring environmental and social impacts of and on bank activities. Without better tools, regulators cannot monitor bank impacts for “safety and soundness.”

---

4 Federal Reserve Board of Governors, Assets and Liabilities of Commercial Banks in the United States Release H. 8 (May 8, 2009), <http://www.federalreserve.gov/releases/h8/Current/>.

5 This discussion draws on the insights of Thomas Greco Jr., Ellen Brown, Bernard Lietaer and others who ask what “money” is and how it comes to be.

6 FDIC, Uniform Bank Performance Reports, <http://www.ffiec.gov/UBPR.htm>.

7 <http://www2.fdic.gov/sdi/index.asp>.

8 FDIC, Bank Data & Statistics, <http://www.fdic.gov/bank/statistical/index.html>.

9 FFIEC, <http://www.ffiec.gov/>.

10 FFIEC, Community Reinvestment Act Data Products, <http://www.ffiec.gov/cra/craproducts.htm>.

11 Rooted in 1930s Depression-Era common experience, federal regulatory formulas presumed bankers’ social commitment to prudently invest community wealth entrusted to them. Since the 1980s, Wall Street firms paid its top management large bonuses, guaranteed even during years of massive firm losses. Split incentives at two levels became the economic order: an individual manager’s wealth was not a function of bank profit, and bank profit was disconnected from social profit. The accountability voids let subprime lending and the structured products built on inflated real estate mortgage pools balloon out of control. Through campaign finance and other means, social accountability via regulatory oversight lagged the bank industry’s practices and impacts.

## Information about Bank Impacts is Available but Scattered

Major commercial banks have environmental, social and governance (ESG) performance ratings.<sup>12</sup> Despite a bank's corporate ESG ratings, the environmental and social impacts of its business and personal loans (92 percent of bank assets) remain virtually hidden.<sup>13</sup> Corporate governance, corporate social responsibility, ESG, the United Nations' Global Reporting Initiative, the Equator Principles<sup>14</sup> and for financial institutions CRA represent a rising tide of annual ratings and reports through which banks' environmental and social performance can be measured within their industry, and compared to other industries.

## Designing a High-Transparency Bank

Urban Logic<sup>®</sup> has designed a high-transparency bank.<sup>15</sup> As envisioned, GoodBank<sup>™</sup> would let customers (i) see whether their money meets the individual's environmental and social impact goals and (ii) use affinity group banking to improve regional quality of life. Key design elements include:

1. **High-Transparency:** Instead of minimal transparency as regulatory burden, GoodBank designs transparency into all services, governance and other features.
2. **Underwriting, Risk Management & Corporate Governance:** Prudent bank operations and management are augmented by visualizing environmental and social impacts. Reliable data about how regions absorb and buffer needs, changes and shocks come together in a model to produce a financeable blended measure of quality of life challenges and strategies (sustainable resiliency<sup>®</sup>).
3. **Incentives:** Eighty-five percent of Americans carry a rewards card. Nearly half of all Americans, and 41 percent of conscious consumers carry three to five rewards cards.<sup>16</sup> At GoodBank, the customer's banking relationship improves based on spending and non-spending (savings) in line with their chosen social impact goals. Consuming more mindfully becomes rewarding through cash-back rewards, more competitive interest rates and reduced fees.

---

12 Independent ESG rating service providers for the socially-responsible investment (SRI) mutual fund industry include ASSET4, Innovest, KLD and TruCost.

13 An exception, home lending, is partially documented as social impact finance.

14 Equator Principles for Project Finance, [www.equator-principles.com/reporting.shtml](http://www.equator-principles.com/reporting.shtml). See also, BankTrack, Banks Lack Robust Framework for Minimizing Social Risks: Equator Principles fail to adequately address human rights (Washington 2008), [www.banktrack.org/show/news/banks\\_lack\\_robust\\_framework\\_for\\_minimizing\\_social\\_risks](http://www.banktrack.org/show/news/banks_lack_robust_framework_for_minimizing_social_risks).

15 Urban Logic, GoodBank Project Wiki, [www.goodbank.info/w](http://www.goodbank.info/w). GoodBank<sup>™</sup> is the design for a bank yet to be chartered, and therefore not yet in operation.

16 Consumer Reports, Points Mania (July 2008), [www.consumerreports.org/cro/money/credit-loan/rewards-cards/overview/rewards-cards-ov.htm?resultPageIndex=2&resultIndex=12&searchTerm=reward percent20cards](http://www.consumerreports.org/cro/money/credit-loan/rewards-cards/overview/rewards-cards-ov.htm?resultPageIndex=2&resultIndex=12&searchTerm=reward%20percent20cards).

4. **Individual Values:** As consumers use credit and savings to buy products and services aligned with their chosen environmental and social impact goals, the interest rate, cash back rewards and other features of their bank relationship shift, in recognition of their reliable, goal-driven behavior (using a mobile Web service, the Means Meter®).
5. **Business Banking:** As businesses set supply chain accountability, fair labor, environmental and other goals to grow “triple bottom lines” (profit, planet and people), their cost of capital and fees for merchant card services improve. The company’s sustainability data helps brand and market to conscious consumers.
6. **Social Sector Banking:** Non-profits, foundations, social entrepreneurs (including many graduating universities or shifting careers today) and faith-based organizations form the “social sector.”<sup>17</sup> GoodBank takes quantifiable contributions to the community’s sustainable resiliency into account in setting interest rates.
7. **Procurement Visualization:** The bank will help local businesses see relevant corporate and government procurements and pre-qualify them for working capital and other loans needed to win contracts that revive local jobs and economic development.
8. **Growing Change:** Cash-back rewards become “complementary currency” that can be invested in micro- and social enterprises and other activities that augment sustainable resiliency as each customer believes best.
9. **A Change Agent’s Compass:** To leverage the bank’s role as change agent,<sup>18</sup> we map the world’s needs, capacities and money, where needs are represented by sustainable resiliency®, capacities are an open Google Earth/Wikipedia-like mash-up of solutions available to address needs, and money relate to the government, corporate and private funding to connect needs and capacities. Through the 3 Layered Map, the bank and its customers better see tipping points<sup>19</sup> that their ethical banking can leverage. For instance, if a conscious consumer or business believes that fair trade labor is an issue that could be influenced by purchasing from ethical sources, the Map would reveal advocacy arguments, marketing promotional content and sources of foreign assistance to address that cause, alongside using GoodBank’s affinity group tools to engage other customers in making change happen faster.
10. **Affinity Group Tools:** Bank customers who are motivated to address a cause, community or region of concern will be given the option to self-identify as affinity groups so

---

17 This is called the Third Sector in the United Kingdom, with its own national government programs. Cabinet Office: Office of the Third Sector, About Us (November 23, 2008), [www.cabinetoffice.gov.uk/third\\_sector/about\\_us.aspx](http://www.cabinetoffice.gov.uk/third_sector/about_us.aspx).

18 Neil Porter Brown, Change Agent: William Drayton promotes socially conscious entrepreneurs (Harvard Magazine March-April 2002), <http://harvardmagazine.com/2002/03/change-agent.html>.

19 Malcolm Gladwell, The Tipping Point : How Little Things Can Make a Difference (2000), [http://en.wikipedia.org/wiki/The\\_Tipping\\_Point](http://en.wikipedia.org/wiki/The_Tipping_Point).

as to inform the bank of their unique knowledge, have authenticated data on the issue flow into bank underwriting (through sustainable resiliency metrics), and to invest their Means Meter cash back rewards in third party social entrepreneurs who innovate solutions that add to sustainable resiliency.

11. ***Social Financial Literacy:*** In bank branches and online, social financial literacy technologies will offer new options to learn, teach and discuss financial responsibility in terms of family, community and global impacts.
12. ***Incubate High-Transparency Bank Technologies:*** Instead of a large branch network, the bank will operate destination branches, and license social financial literacy technologies to other community banks and financial institutions seeking to become highly transparent, thus growing the asset classes and marketability of bank receivables.

## A Practical Example

Imagine a consumer looking for sustainable toothpaste walks into their favorite supermarket, with an Apple iPhone or an Android phone.<sup>20</sup> Scanning her regular toothpaste's bar code with her phone, the consumer does three things: shop, compare and buy. She compares prices at neighborhood stores, and whether the toothpaste brand chosen and the store itself are the most sustainable, using preselected ratings data. In short order, she swipes the phone at the checkout counter to make the purchase, like a credit card. The phone also records and shares what she learned through applications for personal financial management (e.g., Mint and Wesabe) and social networking (e.g., Facebook).

Most of these applications exist today. What is missing is a bank that rewards the consumer who makes and keeps a commitment to sustainability (or any other) social impact principles. Through GoodBank, the consumer is rewarded for shopping consistent with her values, for keeping her word to herself. Mindless credit is turned into mindful credit. Web data about products transforms from manipulating ads into meaningful purpose at point of sale. Personal credit scores are managed in real time, not as breaches of commitments after the fact.

GoodBank's design takes a normal commercial bank, and adds enhanced information tools that help customers improve their money's impacts. The bank exchanges money and impacts information with its customers. Profitability is a function of reducing costs and adding new revenue sources. The bank pays financial and social returns, with the psychic returns being in some cases more meaningful and creating a more loyal customer base. Loyalty reduces the bank's costs to find and keep customers' business. Customer affinity goals reduce bank credit and liquidity risks, while improving the overall user experience and driving the mission of the bank. Loans tied to the customer's environmental or social goals

---

<sup>20</sup> Google/Open Handset Alliance, What is Android?, [www.android.com/about](http://www.android.com/about).

create a new asset class of debt, socially responsive debt (SRD), that can be aggregated into bank-managed funds for mission-related investors, such as pension funds, to complement their socially responsible investments (SRIs). This SRD origination process reduces the bank's credit risks while adding new capital access. With the loyalty of conscious consumers, the bank can reward its triple bottom line business customers, while highlighting and financing non-profit and social sector entrepreneurs. As an incubator for social financial literacy technologies, the bank generates and provides an outlet to share new media content. It earns royalty revenue from licensing new technologies to peer banks, so as to reduce the technology development costs and risks.

As a high-transparency bank, GoodBank's design reattaches meaning to the money it creates through credit formation. As a demonstration project, GoodBank will leverage trends and systemic shifts described in the balance of this article.

### **Anticipating the Demand for Semantic Banking Services**

The semantic web (sometimes called Web 2.0/3.0) promises to tag data in such a way as to create a virtual periodic table or Dewey decimal system of self-organizing knowledge. With the semantic web, Google-like product searches will retrieve trustworthy, actionable information for consumers in a Wikipedia-like taxonomy, along an ever expanding and deepening map of supply chains and their impacts.<sup>21</sup> The semantic web will hold corporations, nonprofits, foundations and governments more accountable for environmental and social impacts.<sup>22</sup> Researching product supply chain information on the web will become easier as an affinity group activity, leveraging each individual's curiosity, query or concern.

The semantic web will support transactions that leverage community impact. Imagine that a consumer wants to consciously support local living economies<sup>23</sup> by buying from local merchants, farmers and service providers. When the consumer pays by credit card, the interest rate, cash-back rewards and other features can take such conscious, social-impact choices into account. The banks issuing and honoring the credit card can serve as conduits for transacting environmental and social good.

The next decade (2010-2020) could moderate growth in consumer debt levels by a tiered credit system that rewards consumers who commit to incur debt for products and services that improve the world around them. Between 1998 and 2008, use of the Internet grew 167 percent, average online purchases grew 2,156 percent, average consumer debt grew

---

21 Bruce Cahan, Helping Consumers Buy Products that Reflect their Values (Google Tech Talk February 8, 2008), <http://www.youtube.com/watch?v=niGJCNN1FbA>.

22 UK banks operating through the traditional banking model are somewhat skittish about adopting semantic web features that let affinity groups "control" their brands. Finextra, Fears of brand damage scaring banks away from Web 2.0 (February 23, 2007), <http://www.finextra.com/fullstory.asp?id=16563>.

23 See, BALLE: Business Alliance for Local Living Economies, [www.balle.org](http://www.balle.org); Woody Tasch, Inquiries into the nature of Slow Money: Investing as if food, farms and fertility mattered (Slow Money Alliance 2008), <http://www.slowmoneyalliance.org/>; Michael Shuman, The Small-Mart Revolution (BALLE 2006), [www.small-mart.org/](http://www.small-mart.org/).

70 percent, and the share of disposable household income spent on debt service increased 16.5 percent.<sup>24</sup> Viewed from this perspective, consumer debt financed the first decade of the Web's widespread adoption. Rethinking consumer debt for the U.S. economy means pivoting how consumers spend their 70 percent share of gross domestic product.<sup>25</sup>

Today, credit cards are digital one-way mirrors: banks look in on us as credit users, but provide none of the tools for us to aim our values out at the world. Naturally, we consume both product and credit, unaware of impacts. Worse, the information gaps from manufacturers and banks, and the lack of credit incentives dull us to the point of associating branding with social impact, "green-washing" us with goodness.<sup>26</sup>

## SRI, Conscious Consumerism and "Green"/Sustainability Accounting Data

Socially responsible investment portfolios composed of each industry's ESG leaders

24 For U.S. population, see American Factfinder, Table T1: Population Estimates, 2008 Population Estimates (Washington, DC: U.S. Census Bureau, 2008), [http://factfinder.census.gov/servlet/DTable?\\_bm=y&-geo\\_id=01000US&-ds\\_name=PEP\\_2008\\_EST&-\\_lang=en&-mt\\_name=PEP\\_2008\\_EST\\_G2008\\_T001&-format=&-CONTEXT=dt](http://factfinder.census.gov/servlet/DTable?_bm=y&-geo_id=01000US&-ds_name=PEP_2008_EST&-_lang=en&-mt_name=PEP_2008_EST_G2008_T001&-format=&-CONTEXT=dt). For internet use, see Internet World Stats, United States of America: Internet and Broadband Usage Rates, <http://www.internetworldstats.com/am/us.htm>; World Bank, Data and Statistics, Key Development Data and Statistics (Geneva: World Bank, n.d.), <http://web.worldbank.org/WBSITE/EXTERNAL/DATASTATISTICS/0,,contentMDK:20535285~menuPK:1192694~pagePK:64133150~piPK:64133175~theSitePK:239419,00.html>; and Central Intelligence Agency, World Factbook: Internet Use in U.S. in 2008: Country Comparison, <https://www.cia.gov/library/publications/the-world-factbook/rankorder/2153rank.html>. For consumer debt, see Federal Reserve Board, Consumer Credit Outstanding (historical tables), [http://www.federalreserve.gov/releases/g19/hist/cc\\_hist\\_sa.txt](http://www.federalreserve.gov/releases/g19/hist/cc_hist_sa.txt). For household debt service, see Federal Reserve Board, Statistical Release: Consumer Credit Release G.19 (Washington, DC: Federal Reserve Board, July 8, 2009), <http://www.federalreserve.gov/releases/g19/current/g19.htm>. For e-commerce, see U.S. Census Bureau, Table 3. Quarter Ending Retail Sales (Total) Retail Sales (E-Commerce) (Washington, DC: U.S. Census Bureau, March 2009), available at <http://www.census.gov/mrts/www/data/html/09Q1table3.html>.

25 U.S. Bureau of Economic Analysis, National Income and Product Accounts Table 1.1.5. Gross Domestic Product, <http://www.bea.gov/national/nipaweb/TableView.asp?SelectedTable=5&FirstYear=2008&LastYear=2009&Freq=Qtr>.

26 Natural Marketing Institute, 2007 LOHAS (Lifestyles of Health and Sustainability) Consumer Trends Database, as reviewed in Green Labels Positively Impact Purchase Behavior (Environmental Leader May 20, 2008), <http://www.environmentalleader.com/2008/05/20/green-labels-positively-impact-purchase-behavior/>. The 2007 LOHAS Database found that some sustainability certifications are more likely to impact consumer buying decisions. Nielsen finds that companies that enter the sustainability marketing space invite active blogger and therefore media oversight, and must be more accountable for sustainability claims than companies not participating in the "green economy." See Nielsen Online, Greenwashing: Who's Winning the Green Race Online? (April 2008), [http://www.nielsen-online.com/emc/0803\\_wb/NielsenOnline\\_Sustainability\\_Webinar\\_April%202008\\_Clients.pdf](http://www.nielsen-online.com/emc/0803_wb/NielsenOnline_Sustainability_Webinar_April%202008_Clients.pdf). These trends suggest banks that feature "green" or "sustainability" as part of their brands will invite greater scrutiny for environmental and social impacts, thereby adding "millions of eyeballs" (webby speak for online traffic) to the resources of bank regulators. Were social impacts of credit a pervasive feature of bank reporting and management, subprime and other predations would not long survive in the marketplace.

appear to outperform ESG laggards.<sup>27</sup> In 2006, the movie *Inconvenient Truth*<sup>28</sup> featuring Vice President Al Gore galvanized a national commitment to spend less wastefully and reduce our carbon footprints. Causal campaigns like PRODUCT (RED)<sup>29</sup> to eradicate HIV/AIDS in Africa, and web services such as Coop/Green America<sup>30</sup> that rank the ESG impacts of everyday consumer products, use social impact brand identity and third-party ratings to drive market demand towards more ethical manufacturers. Affinity groups on social networks, such as Causes on Facebook,<sup>31</sup> and influential blogs inform and define themselves regarding social causes, and represent the purchasing power and capital to shift market dynamics.

Hundreds of “goodness” ratings – everything from organic kosher or halal foods to LEED certified building materials, from Energy Star electric devices to fair trade coffee and clean fish – are proliferating. The cacophony of consumer product ratings denotes a new market segment (conscious consumerism). Ironically, each industry and its regulators promote insular sustainability ratings, not comparable across industries or within common in-home settings. The ratings cacophony has led large retailers (such as Home Depot<sup>32</sup> and WalMart<sup>33</sup>) to brand their own meta-ratings of sustainability.

Location-aware (geospatial) data, printed documents and financial reports once represented digital Towers of Babel. Now they are published and shared in robust interoperable formats, with the semantics for portable use already tagged.<sup>34</sup>

When prompted by advantageous access and terms from global credit markets, an open standard format for interoperably sharing of ESG ratings data will emerge as lightweight, simple, pedigreed and archival.

---

27 SAM Sustainable Asset Management AG and Pricewaterhouse Coopers, *The Sustainability Yearbook 2009* (2009), [http://www.sam-group.com/yearbook/download/yearbook\\_current.pdf](http://www.sam-group.com/yearbook/download/yearbook_current.pdf), at page 11. SAM’s Yearbook found that over a ten-year period ESG leaders outperformed ESG laggards by a cumulative 15 percent. Some of ESG leaders’ higher stock valuations are consistent with an increasing percentage of corporate market capitalization being attributable to “intangibles” (e.g., corporate brand value and reputation). Id., at p. 8. Another study found an annualized improvement in portfolio return of 3 percent by choosing environmental leaders over laggards. See Innovest, *Carbon Beta and Equity Performance: An Empirical Analysis Moving from Disclosure to Performance* (October 2007), <http://innovestgroup.com/images/pdf/carbonbetaequityperformance-delivered.pdf>.

28 Participant Media, *An Inconvenient Truth* Movie, <http://www.climatecrisis.net/>.

29 The Persuaders, *Product(RED)*, <http://www.joinred.com/Home.aspx>.

30 Green America, <http://www.coopamerica.org/>.

31 Project Agape, *Causes*, <http://apps.facebook.com/causes/about>.

32 SCS Scientific Certification Systems, *The Home Depot Eco Options*, [www.scs-certified.com/lcs/eco\\_options.php](http://www.scs-certified.com/lcs/eco_options.php).

33 Walmart, *Global Sustainability Report*, <http://walmartstores.com/Sustainability/7951.aspx>. Rosabeth Moss Kanter, *Wal-Mart’s Environmental Game Changer* (*Harvard Business Review* July 16, 2009), <http://blogs.harvardbusiness.org/kanter/2009/07/walmarts-environmental-gamecha.html>.

34 Geospatial content from thousands of sources is now found semantically through the Open Geospatial Consortium’s KML standard. Geodata is accessed through Google Earth, GPS navigation units and other web services. Semantically-tagged content in documents online is shared as HTML format on millions of websites. Mike Wesch, *Web 2.0: Digital ethnography, the machine is us/ing us*, [www.youtube.com/watch?v=NLIgopyXT\\_g&feature=channel](http://www.youtube.com/watch?v=NLIgopyXT_g&feature=channel). Corporate financial reporting data filed with the FFIEC and SEC can be mined in eXtensible Business Reporting Language (XBRL) format.

## E-Commerce Businesses Justify Updating Bank Models

High-transparency banking also serves business customers. E-commerce between businesses (business-to-business, or B2B), accounts for 93 percent of all e-commerce transactions.<sup>35</sup> Retail sales negotiated electronically (business-to-consumer, or B2C) represent the balance of e-commerce activity, and less than 4 percent of all retail sales.<sup>36</sup> The environmental and social impacts of B2B e-commerce can be seen through authenticated supply-chain ordering, and could be reported in such standardized formats as GRI's template using XBRL.<sup>37</sup> Despite the predominance of business e-commerce, banks have yet to seek and leverage environmental and social information about B2B exchanges.

### Another example

Assume a local grocer sells organic foods. To verify wholesomeness, its suppliers provide supply chain data about the labor, ingredients and carbon footprint used to bring the food from farm field to the grocer's shelf. The grocer pays the extra data costs to attract and retain conscious consumers. Through a high-transparency bank, the grocer earns more favorable working capital, credit card and other terms by providing the sustainability data that the bank's depositors need to achieve their ethical goals. Thus, the grocer's B2B supply chain data captures more loyal customers and better bank rates.

## Lift the Black Box that Hides Banks Impacts

The current commercial bank is a black box that shuns impacts analysis.<sup>38</sup> Since January 1, 2008, the lack of impacts transparency in banking has proved unaffordably quaint by every measure: the failure of 81 banks (through July 10, 2009);<sup>39</sup> \$700 billion to stabilize the biggest banks, car companies and their credit companies and financial re-insurer AIG;<sup>40</sup> \$440 billion to rescue Fannie Mae and Freddie Mac;<sup>41</sup> a 60 percent drop in share prices for major

35 U.S. Census Bureau, E-Stats on E-Commerce through 2007 (May 28, 2009), [www.census.gov/eos/www/2007/2007reportfinal.pdf](http://www.census.gov/eos/www/2007/2007reportfinal.pdf), at p. 2.

36 U.S. Census Bureau, Table 3. Quarter Ending Retail Sales (Total) Retail Sales (E-Commerce) (Washington, DC, March 2009), available at <http://www.census.gov/mrts/www/data/html/09Q1table3.html>.

37 Global Reporting Initiative, <http://www.globalreporting.org/ReportingFramework/G3Guidelines/XBRL/>.

38 Wikipedia, Black Box, [http://en.wikipedia.org/wiki/Black\\_box](http://en.wikipedia.org/wiki/Black_box).

39 FDIC Failed Bank List, [www.fdic.gov/bank/individual/failed/banklist.html](http://www.fdic.gov/bank/individual/failed/banklist.html).

40 The Troubled Asset Relief Program (TARP) under the Emergency Economic Stabilization Act of 2008., <http://thomas.loc.gov/cgi-bin/bdquery/z?d110:HR01424:@@L&summ2=m&>.

41 Preferred stock investments under the Housing and Economic Recovery Act of 2008, <http://thomas.loc.gov/cgi-bin/bdquery/z?d110:HR03221:@@L&summ2=m&>.



banks;<sup>42</sup> a 23 percent drop in home prices<sup>43</sup>; the irony that 60 percent of TARP aid went to banks with “Outstanding” CRA ratings;<sup>44</sup> and the expectation that banks will lose or write down another \$470 billion in 2009-10.<sup>45</sup>

This article leaves it to others to explain in charts, regression statistics, financial analytics and legislative histories the underlying causes of America’s banking system ills.<sup>46</sup> Looking backward is not the point taken up here. Rather, the view forward deserves exploration to evolve more stable, less predatory banking models.

## High-Transparency Banking as Part of Federal Bank Regulatory Reform

Americans have earned the right to bank at high-transparency banks, through massive direct subsidy and net operating loss carry-forwards in the hands of TARP recipients,

If we faced a new national pandemic, government research and development dollars would not be invested in deploying existing vaccinations and inoculations. If we faced a cyber threat, resiliency investments would not be sequestered amongst a small group of government vendors. We are a nation of innovators, building new models for old capacities that demand updating and improvement. Banking is just such an opportunity to create new capacities through high-transparency banks.

The charter for a high-transparency bank should recognize its special characteristics and public purposes:

- **Mutual/Two-Way Transparency:** Transparency would be an enterprise-wide revenue strategy, not just a compliance or marketing matter. This would more directly empower customers with a 360° view of their own individual and affinity group financial reach, risk and impacts.
- **Hybrid Profit Management:** Clear corporate charter and governance provisions would permit bank management to prefer quantifiable social return over financial return,

---

42 For the decline in one widely-used bank stocks index, see Standard & Poor’s 500 Banks Index, [www.bloomberg.com/apps/quote?ticker=S5BANKX percent3AIND](http://www.bloomberg.com/apps/quote?ticker=S5BANKX percent3AIND).

43 For home price declines, see Standard & Poor’s/Case Shiller Home Price Index, [http://www2.standardandpoors.com/spf/pdf/index/CS\\_HomePrice\\_History\\_063055.xls](http://www2.standardandpoors.com/spf/pdf/index/CS_HomePrice_History_063055.xls).

44 For TARP recipients’ CRA ratings, see, <http://www.ffiec.gov/craratings/default.aspx> and <http://www.ustreas.gov/initiatives/eesa/transactions.shtml>. In most cases, TARP recipient’s CRA ratings filings or exam data is more than two years old, and in some cases much older. It would appear that TARP recipients were not required to update their CRA ratings as a precondition of funding. Non-banks (such as AIG, Chrysler and General Motors) were not previously subject to CRA filing requirements, and therefore no CRA data is available for those recipients. For purposes of calculating the footnoted statistic, where a TARP recipient (such as Goldman Sachs) had a subsidiary with a CRA rating, that rating was attributed to the parent entity, absent a parent’s CRA filing. A bank holding company (such as CIT Group) does not provide CRA ratings.

45 Moody’s, <http://seekingalpha.com/article/141219-u-s-banks-to-lose-or-write-down-470b-through-2010-moody-s?source=feed>.

46 See, e.g., U.S. Treasury, [www.FinancialStability.gov](http://www.FinancialStability.gov) and Financial Regulatory Reform, [www.financialstability.gov/docs/regs/FinalReport\\_web.pdf](http://www.financialstability.gov/docs/regs/FinalReport_web.pdf). Ellen Brown, *Web of Debt* (3rd Edition – December 2008), <http://www.webofdebt.com/>.

provided “safety and soundness” are not compromised or put at unreasonable market risk.<sup>47</sup> “Social return” would be maximized both inside and outside of the primary geography of the bank’s branch network. Just as Community Development Financial Institutions (CDFIs) address local concerns, high-transparency banks would in effect globalize bank social context, concern and performance.

- ***Interoperability Standards Leadership:*** Membership in existing or new ISO-compliant information technology standards consortia would develop shared, functional open interoperable data formats (including, but not limited to, spatially-aware XBRL) for portraying the environmental, social and other impacts achieved through high-transparency banking.
- ***Open Impact & Exchange Metrics Integration:*** Mandatory collaboration through such consortia would develop a common open exchange format for complementary currencies (cash-back rewards, time donations and other non-dollarized transactions) that serve to empower communities. The consortia’s standards would extend systems for seeing how such alternative currencies address environmental and social issues.
- ***CDFI Status:*** The functional equivalent of CDFI status would encourage investment and implementation by high-transparency banks (using the adopted open standards) to spur quantifiable social returns in domestic or foreign settings of special concern.

What to include in a high-transparency bank charter merits public debate. Systemically, growing a group of highly semantic, impacts-aware banks would demonstrate the technical potential – the higher watermark - for commercially feasible bank transparency, prototyping what traditional commercial banks could achieve with appropriate regulatory incentive and review. Open standards developed by high-transparency banks would augment options for regulatory oversight and intervention based upon earlier detection of adverse environmental, economic and social impacts.

## Conclusion

An era of high-transparency banking is on the horizon. Perhaps in response to the 2008-9 Credit Crisis, perhaps leveraging the semantic web, perhaps in response to climate change, global poverty, public health or social concerns, such banks will become a new force for restoring trust and confidence in America’s bankers. They will redefine the industry’s brand image and legacy.

The shift towards high-transparency, social impacts banking has already begun. High-transparency has roots and precedent in Europe’s “ethical banks” and the long term thinking of innovators like Triodos Bank in the Netherlands, Co-Operative Bank in the United Kingdom,

---

<sup>47</sup> A similar social profit charter option is developing for ordinary (non-bank) organizations. See, B Corporations, <http://www.bcorporation.net/> and Vermont’s Low-Profit Limited Liability Company, [http://www.sec.state.vt.us/corps/dobiz/llc/llc\\_13c.htm](http://www.sec.state.vt.us/corps/dobiz/llc/llc_13c.htm).

Banca Etica in Italy and Banco Real in Brazil.<sup>48</sup> Early precedent in the United States includes community banks like Shorebank in Chicago and Wainwright Bank in Boston, and “green” banks in the Pacific Northwest like Shorebank of the Pacific.

Out of necessity or opportunity, new models for high-transparency, trustworthy banks are emerging, including GoodBank. With increasingly robust social impact ratings systems and encouragement from an updated bank regulatory framework, high-transparency banks will prosper, grow, and acquire market share from high-camouflage, traditional banks.

*Bruce Caban, an Ashoka Fellow and a nonresident fellow of Stanford’s Center for Internet and Society, is President of Urban Logic, Inc., the nonprofit sponsor of the GoodBank Project ([www.goodbank.info/w](http://www.goodbank.info/w)), providing research to organize a high-transparency bank*

---

48 Rosabeth Moss Kanter & Ricardo Reisen De Pinho, Banco Real: Banking on Sustainability (Harvard Business Case April 13, 2005), <http://harvardbusiness.org/product/banco-real-banking-on-sustainability/an/305100-PDF-ENG?Ntt=Rosabeth%2520Moss%2520Kanter#>.

# Impact Investing:

Harnessing Capital Markets to Solve Problems at Scale

*Antony Bugg-Levine*<sup>1</sup>

*Rockefeller Foundation*

*John Goldstein*

*Imprint Capital Advisors*

There is not enough charitable and government capital to meet the social and environmental challenges we face. Where, then, will we find the money to complement charity and government to bring solutions to scale? The Rockefeller Foundation launched its Harnessing the Power of Impact Investing initiative in November 2008 because it believes that impact investing can be part of the answer. Imprint Capital was similarly founded in 2007 to help the growing ranks of institutions and high-net-worth individuals create and execute strategies to drive impact with their investments.<sup>2</sup>

However, as the report *Investing for Social and Environmental Impact* by the Monitor Institute highlights, the ability of this new industry to deliver on its potential is not inevitable. Industry leaders must work together to measure and articulate the industry's successes, build infrastructure to increase its efficiency, and create products that respond to investors' demand for transparency and liquidity.

Impact investing helps solve social or environmental problems while generating financial returns. The pioneering investors are diverse, with a variety of motivations. Despite the current market turmoil, by recognizing they are part of a broader industry, participants can learn from recent innovation and work strategically to improve the efficiency and broaden the capacity of impact investing. These developments present new opportunities for banks in new investments, co-investors, and collaborators. Consider the following examples:

*A family in New Jersey is moving into a newly renovated, previously foreclosed home. The home is affordable because the nonprofit organization Housing and Neighborhood Development Services Inc., received timely access to a low-cost loan. That loan enabled it to buy 47 distressed mortgages from JP Morgan Chase from the Washington Mutual portfolio, renovate and sell them for a profit. The capital for the purchase of the loans came from Prudential's Social Investment Fund.*

---

1 An earlier version of this article appeared in the May/June, 2009 edition of *Beyond Profit* magazine ([www.beyondprofitmag.com](http://www.beyondprofitmag.com)).

2 Disclosure: The Rockefeller Foundation currently has investments with Root Capital. As of the writing of this article, Imprint Capital Advisors has client investments in Southern Bancorp, Community Capital Management, Acelero, Habitat for Humanity, and OneCalifornia Bank; is reviewing Root Capital, Revolution Foods, and E & Co on behalf of clients; and has client relationships with the Kellogg Foundation, the Hull Family Foundation, the Annie E. Casey Foundation, the MacArthur Foundation, and RSF Social Finance.

*A four-year-old child in Clark County, Nevada, will be ready for kindergarten thanks to Acelero, a for-profit company that takes over failing Head Start programs. Acelero's growth has been fueled by equity investments from Boston Community Ventures (a Community Development Finance Institution), New Schools Venture Fund (a philanthropic investor in high-impact educational enterprises), Ironwood Ventures (a double bottom line private equity firm), and the Kellogg Foundation.*

*The National Community Stabilization Trust (NCST) is partnering with cities around the United States to augment state and federal funds allocated to combat the foreclosure crisis. With seed funding from the MacArthur Foundation and a \$50 million program-related investment from the Ford Foundation, NCST bids on properties on an exclusive basis as they are prepared for auction, stretching scarce grant dollars farther to buy and rehabilitate properties and preserve communities.*

*Around Virunga National Park in the Eastern Congo, farmers are receiving premium prices for vanilla and coffee sold to Gourmet Gardens, a Ugandan exporter. Despite the political instability that keeps mainstream lenders away, Gourmet Gardens secured a working capital loan for these purchases from Root Capital, a U.S.-based nonprofit organization that lends to farmers' cooperatives and agriculture aggregators around the world. Its balance sheet is capitalized by corporate investors such as Starbucks, social investors such as Prudential, and various private foundations and investments from high net worth individuals.*

*In Los Angeles, a six-year old girl gets a healthy lunch and snack every school day made with fresh ingredients thanks to Revolution Foods. Since launching in 2006, Revolution Foods has served more than 2 million healthy school lunches to nearly 25,000 kids, 80 percent of whom qualify for free or reduced lunch. Revolution Foods has been financed by a combination of high net worth individuals, conventional venture capitalists and a double bottom line venture fund backed by banks and foundations.*

*In Toledo, Ohio, an unemployed factory worker who previously worked for an auto supplier is interviewing for a job with Xunlight at a reopened factory. This former glass factory is located in a neighborhood that is 79 percent minority, with income at 73 percent of the area's median income. It is now manufacturing thin-film solar panels and is generating green jobs with financing provided by a bond issued by the Ohio Enterprise Bond Fund and purchased by Community Capital Management.*

*In Oakland, California, a family receives financial literacy training and a bank account that offers a savings match via their local Head Start chapter. In Berkeley, an innovative program for financing residential solar power receives bridge financing. In San Francisco, a group of previously unbanked Hispanics build credit histories by having a bank administer and document their previously informal lending circle. OneCalifornia Bank supports all these efforts. OneCalifornia Bank is a financial institution capitalized initially with*

*\$22.5 million from Tom Steyer and Kat Taylor, owned by the OneCalifornia Foundation, and supported by mission deposits from organizations like the Annie E. Casey Foundation and the Hull Family Foundation.*

Although they may not know it, these people—from the family moving into a new home in New Jersey, the factory workers in Ohio, and residents of Berkeley installing solar panels—are all participating in the rapidly emerging industry of impact investing. Like the individuals and institutions who invested in the New Jersey housing group, impact investors seek for-profit investments that can also provide solutions to social and environmental challenges. In the United States, this field brings together an assortment of players with a range of motivations, from banks investing for Community Reinvestment Act (CRA) purposes, to financial institutions fulfilling their corporate responsibilities and responding to client interest, to foundations engaged in mission-investing, to individuals and family offices expressing their values through their investments.

These impact investors offer a bridge between traditional philanthropy, which incubates innovation and mobilizes attention to exciting solutions, and the private-sector capital markets that ultimately hold the wealth required to advance these solutions to a level proportionate to need.

### **Why Impact Investing Now?**

The seeds for impact investing were sown in the last quarter of the twentieth century with the socially responsible investment and corporate responsibility movements. In the United States specifically, these included the CRA and the rise of the Community Development Finance sector. These efforts challenged the prevailing attitude that companies' and investors' only responsibility is to maximize financial returns. At the same time, as the community-finance movement and microfinance gained international renown and as advocates of a commercial approach to achieving social objectives gained visibility, the idea spread that investment, rather than pure philanthropy, could generate development outcomes. Innovators from a range of quarters have also led the way, including:

- Faith-based investors (e.g., the United Methodist's General Board of Pensions, which has invested across approaches ranging from shareholder engagement to affordable housing);
- Pension funds (e.g., CALPERS with its California initiative; work supporting emerging minority and women-led managers; and Greenwave initiative);
- Private foundations (e.g., The F.B. Heron Foundation's pioneering work in developing investment tool kits for foundations to make impact investments across asset classes and return profiles);
- Insurance companies (e.g., Prudential, whose social investing unit has invested more than \$1 billion across the United States);

- Banks (e.g., Citibank’s work in developing the EQ2 structure to capitalize community-based financial institutions more effectively);
- High net worth individuals (e.g., Investor’s Circle, an angel network that has since 1992 facilitated the flow of more than \$130 million into more than 200 companies and small funds addressing social and environmental issues);
- Hybrid organizations (e.g., Omidyar Network, a distinctive philanthropic investment firm that has committed more than \$270 million to for-profit companies and nonprofit organizations in sectors including microfinance, property rights, government transparency, and social media).

The efforts and examples of these and other organizations have, in turn, encouraged other investors to follow their lead and inspired entrepreneurs and fund managers to develop innovative new impact investing offerings and opportunities. These developments have brought us to the point where these different threads, born from different contexts and driven by various factors, are beginning to form the tapestry that is increasingly recognized as the impact-investing industry.

It would be naïve to believe that the wealth destruction and credit market contractions of the past 18 months have not shaken this new industry. Structural changes that spurred its emergence, however, remain in place to drive its growth when the credit markets revive. These include:

- Wealth concentration among the “investment-oriented”: Many individuals and families acquired significant discretionary capital in the past decade. This capital has been concentrated among precisely those people—entrepreneurs and financiers—whose personal life experiences primed them to see investment as a potent tool for pursuing social impact. They reject the canard that presence of profit is evidence of exploitation.
- Impatience with traditional approaches: After half a century of both remarkable success and failure, traditional philanthropic options are uninspiring to some. This frustration can be counterproductive when it dismisses the experience and insights of those who have been on the frontlines of addressing key challenges, both in the United States and globally. It can also be counterproductive when the frustration ignores the complexity of the challenges at hand. Such frustration, however, creates an opening for social entrepreneurs who offer a compelling alternative to philanthropy.
- Growing societal interest in addressing social and environmental challenges: An interest in using enterprise, investment, and human capital to address core social and environmental challenges has gone from a niche concern among idealists to a mainstream focus. Business schools report oversubscribed classes on social enterprise; mid-career professionals see attractive employment opportunities in roles that enable them to address key social challenges.

- Perception of social and environmental issues as material to business performance and sources of opportunity: Businesses and financial institutions are increasingly viewing their ability to manage social and environmental issues as material to their financial performance. Financial analysts are regularly publishing reports on the impact of climate change on corporate profits and emerging investment opportunities driven by a green stimulus package. Mainstream hedge funds such as GLG have prominently included impact-oriented issues in their fund management approach for purely commercial reasons. Cleantech investments have become commonplace with some leading venture capital firms (e.g., Kleiner Perkins) setting up dedicated funds in the sector.
- Increased interest in public-private partnerships: With both private and public capital constrained in the wake of the financial crisis, interest from both business and government in creating mutually attractive public-private partnerships is moving from a rhetorical assertion to an imperative. Many pressing social challenges—from stabilizing the housing market to addressing climate change—cannot be addressed by governments or private markets alone. The impact-investing industry offers exciting examples of specific deal structures that can enable public and private capital to work together.

### What Will It Take to Harvest the Fruits of Impact Investing?

Despite, and sometimes because of, this proliferation of activity, the impact-investing industry is poised at a delicate moment. Impact investors have already made their mark in a few subsectors, most notably low-income housing in the United States and, more recently, micro-finance and green energy. Yet, impact-investing capital has not yet reached the requisite scale of hundreds of billions of dollars.

The industry remains beset by inefficiencies and distortions that currently limit its impact, even in areas where impact investing should be viable (such as health care delivery, agriculture development, and education). The field's language, analytical tools, capital markets, and legal system do not fully support impact investing, mainly because they are still structured to support the binary poles of either philanthropy or profit maximization. The diverse players who have helped build the field include groups that do not generally collaborate, adding to the complexity and fragmentation of the space.

In this context, impact investing can be frustrating. But these frustrations are not unique. They are the archetypal challenges that confront pioneers in new industries. Fortunately, investors' frustrations are also entrepreneurs' opportunities. Global innovations and collaborations are now pointing to potential solutions to these barriers, including:

***Building platforms for industry development:*** Although various efforts, outlined below, address specific barriers to efficient investing, impact investors need a broader understanding of the contours and structures of this new industry to enable them to work together. Investors need to know how big this industry is, who its participants are, who has capital, who



has deals, and how to connect them more efficiently. In response to this need, the concept for a Global Impact Investing Network is gaining momentum, with hubs of activity coming together across the United States and globally. The network is designed to help build the public goods infrastructure that can lead to a more efficient and effective impact-investing industry. Part of its role is to support, connect, and complement existing organizations focused on specific sectors or markets. These include groups in the United States, such as the Opportunity Finance Network, PRI Makers Network, Social Investment Forum, Investor’s Circle, Social Venture Network, and More for Mission. They also include more internationally focused groups, such as the Aspen Network of Development Entrepreneurs, the International Association of Microfinance Investors, and the Emerging Markets Private Equity Association.

*Creating credible standards for measuring social impact:* Commonly understood terms reduce transaction costs for mainstream investors. The profusion of approaches to assessing impact adds complexity and cost for entrepreneurs and investors seeking or deploying capital in this developing marketplace. Research supported by the Rockefeller Foundation and corroborated by Imprint Capital and others indicates that, among wealth advisors and private bankers, developing a credible, independent rating agency to serve as a “Good House-keeping seal of approval” for impact investments can help unlock capital from this channel. A crucial element of creating these standards is convening leaders within the prominent subsectors of impact investment (e.g., community development, international development, environmental investing, etc.). These leaders can build from existing practice to develop consensus for standards tailored to the specific investing issues in each area. In light of this need, the recent efforts to develop an Impact Ratings and Investment Standards and Global Impact Investing Ratings System is particularly exciting. By mobilizing investors, activists, academics, and entrepreneurs, these initiatives can break through the historic logjam that kept similar efforts fragmented.

*Developing capital markets:* Intermediation within impact investing is generally subscale and inefficient. Impact investors face high transaction costs in sourcing deals, conducting due diligence, and closing and syndicating investments. Investment funds, investment bankers, and market platforms have not yet achieved the scale and visibility to provide viable conduits for billions of dollars of latent impact investment capital. The intermediation challenge is, however, being addressed by innovators working across a spectrum of segments and business models, including:

- *Impact investment banking:* An increasing number of organizations and firms are working, in different ways, to provide investors with more efficient deal-sharing capability, more attractive investment structures, and the liquidity that many require. In the United States, organizations such as Wall Street Without Walls, Calvert Investment Partners, GPS Capital Partners, Godeke & Associates, Brody Weiser Burns, Urban Advisors, Aquillian, NextStreet, and others can serve an array of would-be impact investors.

As investors look abroad, intermediaries with local market knowledge and relationships are proliferating. In London, Social Finance was launched in 2007 as an integrated investment bank serving social-sector clients in structuring and placing impact investment capital. Intelicap in India is expanding its advisory services bouquet to include a range of impact investment services. Yes Bank and Unitus Capital in India are both building up impact investing franchises primarily around sell-side banking services for Indian firms. Similarly, ShoreCap International (an affiliate of Chicago-based ShoreBank) helps connect investors in the United States and Europe with opportunities in Asia and Africa.

- *Wealth advising:* Money managers are tapping client interest in impact investment to expand their customer base and deepen client loyalties. San Francisco-based RSF Social Finance offers their donor-advised fund clients multimanager diversified portfolios of impact investments across asset classes. Building on its work with the KL Felicitas Foundation, Guggenheim Partners has begun to develop a suite of impact investment products, including internally developed and third-party managed options. Wealth advisors based in the United States, ranging from the large private banks to independent firms such as Veris, Baydush Simon Weaver, and Baldwin Brothers offer clients impact investments and screened fund options. ResponsAbility, a Zurich-based money manager launched in 2003, manages more than US\$650 million in impact investments (with net assets growing at approximately \$20 million per month) on behalf of clients of European Union-based private banks. Developed with the support of Credit Suisse, Vontobel, Swiss Re, and other financial players, ResponsAbility demonstrates the potential for specialized managers to partner with mainstream financial players to leverage existing distribution channels and raise assets for impact investing products.
- *Fund management:* A number of impact-oriented fund managers have achieved reasonable scale. Impact Community Capital manages more than \$750 million on behalf of eight large insurers. Bank of America's Capital Access Funds manages or advises on more than \$800 million focused on underserved markets in the United States. Community Capital Management and Access Capital Strategies (recently purchased by Voyageur Fixed Income) manage more than \$900 million and \$600 million, respectively, in community development fixed income on behalf of pension funds, banks, and foundations. Innovators in established fund management companies, such as the managers of impact investing units in TIAA-CREF and Prudential, are building portfolios that total hundreds of millions of dollars across asset classes. Internationally, both Root Capital and E+Co. –US-based non-profits investing in rural businesses and energy services respectively in developing countries—recently launched ambitious scale-up plans. Bridges Ventures in London, the Acumen Fund (an investor in social enterprise in India, Kenya, and Pakistan), GroFin in Africa, and Alsic Funds in Latin America have all increased their balance sheets substantially in recent years.

- *Retail client mobilization:* Innovators have developed mechanisms to make impact investing accessible to retail investors. The Calvert Community Investment Note can be bought in the United States for \$1,000 minimum from brokers (\$20 minimum when purchased online via Microplace). It offers up to a 3 percent coupon. Similarly First Affirmative Financial Network supports its members (registered investment advisors serving socially conscious investors) in offering impact-oriented investments to their clients. Efforts to launch “Social Stock Exchanges” for raising public equity for social enterprises are also gaining momentum in London and Singapore. A number of similar efforts, focused on alternative approaches to public offerings for social enterprise, are at very early stages of development in the United States.

***Building on structuring innovation:*** Although the diversity of the social objective and investors’ return expectations can make the impact investing marketplace seem chaotic, an increasing range of innovations in structuring transactions and funds are turning these differences into assets.

One approach is to create tranching structures that enable investors focused on social return to leverage their capital while reducing the risk for more commercial investors:

- The New York Acquisition Fund leveraged grant money and subsidized investment capital from foundations with senior debt from banks to create a \$230 million pool to finance the purchase of land and buildings for affordable housing. Shaun Donovan, the head of the New York City Department of Housing Preservation and Development and one of the fund’s main architects, is now the Secretary of Housing and Urban Development (HUD) in Washington.
- Internationally, the Alliance for a Green Revolution in Africa (AGRA), a Kenya-based private foundation, recently announced a deal with South Africa’s Standard Bank in which \$100 million of commercial investment in African agriculture will be unlocked by a \$10 million loan guarantee from AGRA. AGRA’s board is chaired by former United Nation’s Secretary General Kofi Annan. In India, the Gates Foundation, Acumen Fund, and ICICI Bank created a similarly structured vendor finance facility for the clean water provider, WaterHealth International.

Innovative fund managers are also becoming increasingly sophisticated in how they provide impact investors the specific investment exposure that meets their social impact goals. For example:

- Community Capital Management and Access Capital Strategies offer investment products that combine the efficiencies of managing a single national fund while allowing different social investors to receive an “allocation” of investments meeting their specific needs (e.g., specific census tracts for banks seeking CRA consideration, specific mission interests for foundations).

- Actis, a prominent global private equity fund with a developmental heritage from the United Kingdom, used a similar approach in raising \$2.9 billion for its Actis Emerging Markets 3 Fund. It gives development agencies with specific geographic interests an allocation to specific countries within their global fund.

Investors are also partnering creatively with foundations and nongovernmental organizations (NGOs) to provide impact-investment funds with both strong investing fundamentals and social impact credibility. The Northwest Louisiana Community Development fund is a double-bottom-line real estate fund partnership between the Strategic Action Council (a 38-member coalition of community groups) and Kennedy Wilson, a national real estate manager. Both the fund manager and the council will receive a carried interest tied to the performance of the fund. Kennedy Wilson will take responsibility for investment decisions while SAC will be responsible for impact objectives. This distinctive hybrid approach brings strong community buy-in and support that aids in meeting the fund's financial and social objectives. As a result, it has attracted a range of investors, including the F.B. Heron Foundation, TIAA-CREF, JP Morgan Chase, the Annie E. Casey Foundation, and the Kellogg Foundation.

### **Securing Supportive Policy Reform**

Despite this proliferation of innovation, for-profit businesses and investors who seek to create social value are still too often left to force-fit their aspirations into existing nonprofit or for-profit legal structures. Legal innovation, however, is also gathering steam. The Dutch government provides capital gains tax breaks to environmentally beneficial investments, which sets a precedent for supportive regulation. The UK government created a new corporate form of for-benefit “Community Investment Corporations” in 2005. In France and South Africa, recent legislation will compel investors to place some of their capital in impact investments.

In the United States, private efforts to create a “B Corporation” (a new classification of company that uses the power of business to solve social and environmental problems) and LC3 legal form are starting to build momentum for a new regulatory regime to meet the interest of impact investors. Clarifying guidance from the Internal Revenue Service could also ameliorate some of the arguably misplaced conservatism that has held many foundations back from engaging in impact investing for fear of legal consequence.

More broadly, the Obama administration's commitment to supporting social innovation coupled with pragmatic partnerships that join government, the social sector, and the investment present the potential for new types of financial and institutional arrangements in sectors ranging from community development, education, to the environment. These arrangements are increasingly crucial to securing the political legitimacy of the Troubled Assets Relief Program (TARP) and other major federal stimulus and bailout expenditures.

## Will Impact Investing Survive the Current Market Turmoil?

Like a butterfly emerging from its cocoon into a hurricane, the impact-investing industry is coalescing just as international credit markets reel. Certain challenges are rooted in the credit crisis, including:

- **Lack of tax credit equity:** In sectors ranging from renewable energy to affordable housing, the lack of tax credit equity investors, owing to both the broader credit crunch and a lack of value for these credits amid corporate and investment losses, has left a significant gap, making many transactions that were once routine challenging or not viable.
- **Lack of access to senior financing:** A general lack of available senior finance has sharply curtailed the ability of risk-tolerant impact investors to catalyze substantial senior capital by taking a subordinate position in tiered risk arrangements. This paucity is rooted in the broad de-leveraging across the global financial system, which affects bank lending, bond markets, and nonbank finance. Credit-enhancement mechanisms (such as monoline insurers) to help address these issues have also disappeared or become prohibitively expensive.
- **Cut-back in Community Reinvestment Act investments:** Many U.S. community development players report a cut-back in investments from CRA groups as banks (appropriately) shore up their balance sheets. In addition, although several new banks have emerged during the prior 12 months, the consolidation among banks has shrunk the field of CRA investors.
- **Capital scarcity:** Budget cuts in government, foundations, corporations, and among individuals have constrained the financial positions of social enterprises and nonprofit organizations, exacerbating the financing shortfalls.

However, there is good news as well. The financial crisis seems to have created a boon in available talent. Around the world, experienced finance professionals, recent business school graduates, and talented expatriates face much lower opportunity costs to enter this industry. In some cases, they are returning to work in emerging markets of increasing interest to impact investors.

Although impact investors are not immune to the challenges of raising capital and syndicating deals in this credit market, anecdotal evidence shows that many remain committed to this new industry. Many of the impact investment asset management, advisory, and banking organizations have remained solvent, and in many cases are growing during a period that has brought mainstream financial services to their knees. Indeed, initial anecdotal indications are that some impact investment portfolios fared well relative to market benchmarks - while the median foundation corpus declined by 26.1% in 2008 according to the Foundation Financial Officers Group, the program-related investment (PRI) portfolios of a number of foundations delivered positive returns. Some of these PRI portfolios have remained

somewhat insulated from recent market volatility and, against that broader backdrop, their modest (< 5%), relatively stable returns have provided a welcome contribution to portfolio diversification and risk management.

Indeed, this environment presents distinctive opportunities. For example, Southern Bancorp, the country's leading rural community development finance institution, is seizing the opportunity to acquire the deposits and selected assets of several institutions in its home state of Arkansas (in one case, at the behest of regulators). These acquisitions, funded primarily with \$11 million in TARP funds, give Southern a low-cost way to expand its integrated rural development work in the Delta region of Arkansas and Mississippi. Similarly, various affordable housing groups are stretching their capital with innovative impact investments to acquire land and properties during the current real estate downturn.

Community groups, foundations, and government have discussed a range of areas for prospective collaborations, ranging from the Department of Education's \$650 million "Invest in What Works and Innovation" fund, to securing TARP funding for Community Development Financial Institutions (CDFIs), to thinking about how the social sector could partner with the FDIC as it disposes of loans and properties from seized banks.

If we could predict with certainty what effect market conditions will have on this industry, we would be making venture capital investments rather than writing articles. In the end, the interplay of income and substitution effects will determine the medium-term trajectory of the impact-investing industry. Industry participants can do little in the short term to address the wealth destruction that is reducing available capital. We can, however, work strategically to position the industry to absorb a greater share of investment capital when markets inevitably thaw.

The success of this new industry is not certain. The danger remains that "impact investing" will become a mere marketing tool that investment promoters use to raise funds without generating substantial social and environmental benefit. It may also be only a convenient means to meet a regulatory or societal requirement. If leaders in the subsectors—community development, microfinance, education finance, health care finance etc.—do not realize the value of coming together to build a single industry infrastructure, they will suffer from duplication and fragmentation. Their individual voices, capabilities, and potential clout are minor compared with what could be accomplished with constructive cross-sector collaboration.

## **Where Does Impact Investing Go From Here?**

We know from the success of other innovations, such as the development of the private equity industry, that a small group of leaders must work effectively to accelerate the pace and manner in which an industry matures. The impact-investing industry will reach its potential in the early years of the twenty-first century if the innovation and stamina of entrepreneurial risk-takers can be coupled with industry-building leadership.

Building a mature impact-investing industry will also require brave self-examination by impact investors and the businesses and funds with which they invest. The impact-invest-

ment industry must be realistic about the returns it will offer and investment products it must develop to become a viable proposition for the institutional investors, who control most of the world's investable assets but are bound by rules that limit their freedom to invest in unproven and submarket products. The industry also must become more confident and honest about explaining the need for subsidy in many areas, through lower returns and higher risk tolerance.

The Monitor Inclusive Markets report on business models to provide basic services to poor customers provides a new benchmark for a thorough analysis of the opportunities and requirements of a specific subsector of impact investing. The report is built on the willingness of enterprises and investors to expose their business practices to public review. It shows that impact investors must accept that subsidies will be temporarily necessary in some subsectors as social enterprises test and refine applicable business models. Subsidies will be permanently appropriate in subsectors where investment generates substantial positive externalities that cannot be internalized into a company's profit.

The economic crisis has shaken confidence in established investment ideologies and their mainstream proponents. The emergence of the impact-investing industry provides a potentially compelling alternative by offering to imbue investment with social purpose and, ultimately, to increase the scope of solutions to social problems that continue to proliferate even as philanthropy resources dwindle.

*Antony Bugg-Levine is a managing director of the Rockefeller Foundation in New York where his responsibilities include leading the Harnessing the Power of Impact Investing Initiative. A native of South Africa, he previously ran the Kenya-office of the NGO TechnoServe and worked as a consultant with McKinsey & Co. He is also currently an adjunct professor at Columbia Business School where he teaches on business and international development.*

*John Goldstein is a managing director of Imprint Capital, a buy-side advisor that helps foundations, financial institutions, and families develop and execute mission investment strategies. Imprint made \$68 million in mission investments across impact areas and asset classes last year. Previously, John co-founded Medley Capital Management, a large global private investment firm, and was senior managing director of Medley Global Advisors, the leading macro-political advisor to the world's largest financial institutions.*

# Increasing Access to Capital:

Could Better Measurement of Social and Environmental Outcomes Entice More Institutional Investment Capital into Underserved Communities?

*Lisa A. Hagerman*<sup>1</sup>

*Boston College Institute for Responsible Investment*

*Janneke Ratcliffe*

*University of North Carolina at Chapel Hill, Center for Community Capital*

The role of capital in promoting growth is more apparent than ever as communities across the country struggle to bolster sagging economies and stem job losses brought on by the credit crunch. Although it may seem now that all markets are undercapitalized, some areas are chronically undercapitalized, including inner-city urban markets, rural markets, low-income communities, and enterprises owned by minorities and women or serving undervalued customer bases. Their struggle for capital means a struggle to thrive, and for owners, entrepreneurs, employees, customers, and communities, whether they will have a chance to reap the benefits of economic opportunity.

In recent years, access to capital for entrepreneurs in underserved markets has grown as institutional investors tap into overlooked investment opportunities in the emerging domestic markets. Institutional investors include public-sector pension funds, foundations, banks, insurance companies, and faith-based organizations. These groups are seeking viable investment opportunities that also spark economic development through more and higher-quality jobs that stimulate local economies; that provide more opportunities for women and minority entrepreneurs; or that benefit the environment.<sup>2</sup>

Institutional investors may refer to this practice as “economically targeted investments,” or more broadly “targeted investing,” “urban investments,” “community-based investments,” “mission-oriented investments,” “double bottom line investments,” or “dual objective investing.”<sup>3</sup> Whatever the name, the practice is a specialized type of investing that seeks, first and foremost, risk-adjusted market rates of return for its investors along with a secondary social return.

---

1 University of North Carolina at Chapel Hill, Center for Community Capital and Oxford University Centre for the Environment.

2 L. A. Hagerman, G. L. Clark, and T. Hebb, “Investment Intermediaries in Economic Development: Linking Public Pension Funds to Urban Revitalization,” *Community Development Investment Review*. Vol 3 (1) (2007): 45-65.

3 This growing industry is examined in by Flynn et al., in which institutional investors have created more than \$6 billion in double bottom line funds nationally between 1998 and 2006. E. Flynn et al. *The Double Bottom Line Handbook: A Practitioner’s Guide Regional Double Bottom Line Investment Initiatives and Funds* (New York: Ford Foundation and Strategic Development Solutions, 2007), available at <http://www.sdsgroup.com/dbl-handbook.html>.



Research demonstrates that through a rigorous and disciplined targeted investment policy, public-sector pension fund investment in these markets can produce both a financial and social return.<sup>4</sup> In fact, there is growing evidence that activities funded with an eye toward both long-term economic impact and profits have outperformed many purely profit-motivated activities in the same space. Perhaps the most telling example lies at the root of the current crisis, in the mortgage market. Banks' mortgage lending activities that were required by regulation (via the Community Reinvestment Act [CRA] of 1977) to serve low- and moderate-income communities were much less likely to be unsustainable, subprime loans, and have defaulted at substantially lower rates than the mostly non-CRA portions of the mortgage market. Indeed, targeted investing presents potentially significant opportunity to achieve both financial profits and external, social benefits. Yet for these benefits to be realized, the field needs a more rigorous and standardized method of measuring the social benefits.

The field has reasonably accurate measures of the financial performance of an investment. Environmental investments are also increasingly measured with broadly accepted standards. However, measuring and explaining the social benefit of an investment is still in its infancy. Although the chorus is growing for measuring social outcomes, there is still no agreed on industry standard. Investors are committing significant amounts of capital to "double bottom line" investment. Consider CalPERS' second \$550 million commitment in 2007 to the California Initiative that is investing in California's underserved markets. However, we believe these amounts could be much greater if there were a way to more clearly measure the good that came from these investments. With such a measure, more capital would flow to that activity.

In this article, we argue that investments attract capital when reliable measurement standards can be applied across different investments.<sup>5</sup> We also argue that incorporating nonfinancial standards in the investment decision process (while still prioritizing financial return) can lead not only to better social outcomes, but also to better financial returns. Instead of being viewed as a tradeoff, there could be a reinforcing effect.

Transparency in social and environmental returns is essential for investors to make informed decisions on their current and future investments in these markets. With transparency, investors can share information to better understand the right questions that lead to both financial and social investment results. In this article, we examine other ratings systems for seemingly different investments that have led to greater investment flows. We offer these examples to explore whether a better, more rigorous system could lead to greater invest-

---

4 The 2008 Pension Funds and Urban Revitalization Initiative developed research in this area. See <http://urban.ouce.ox.ac.uk>. The research estimated that as of 2007, there are approximately \$11 billion of public-sector pension fund commitments (across all asset classes) in urban revitalization, emerging domestic markets, or more broadly, economic development, through either formal targeted investment policies or one-off investments. See Hagerman, Clark, and Hebb, "Investment Intermediaries in Economic Development."

5 This article is a shortened version of working paper completed in July 2008 and can be found at: <http://www.frbsf.org/publications/community/wpapers/index.html>.

ment in the underserved private equity sector. After considering what investors want from social impact metrics, we close with some recommendations about future directions.

## **Comparing Apples to Apples: Ratings Systems Serve as a Tool for Investors**

### *The Rise of Conventional Credit Rating Agencies*

The 1837 financial crisis underscored the need for the service of providing credit history on a business or individual. Louis Tappan, Robert Dunn, and John Bradstreet developed credit rating agencies in the 1840s and 1850s that would later consolidate to form Dunn and Bradstreet.<sup>6</sup> John Moody, a former Wall Street analyst and errand runner, expanded the options in 1909 with his ratings of U.S. railroad bonds. By 1924, Moody's Investors Services covered nearly the entire bond market. Today, Moody's is one of "The Big Three" international credit rating agencies, along with Standard & Poor's and Fitch Ratings. This innovation allowed investors to compare "seemingly incomparable" investments using a simple grade of risk (AAA, AA, A, etc.). With this information, an investor with a given risk tolerance could better evaluate the quality of the potential investment and make more informed investment choices.

### *Environmental Performance Indicators*

The emergence of environmental performance indicators has come about partly because of the commitment of well-established organizations. Ceres (Coalition for Environmentally Responsible Economics) and the United Nations Environment Programme (UNEP) partnered to spearhead the Global Reporting Initiative (GRI). GRI is the first global framework for comprehensive sustainability reporting by corporations, governments, and nongovernmental organizations on economic, environmental, and human rights issues.

The International Organization for Standardization (ISO) is an international network that sets standards, including "generic management system standards" such as the well-known ISO 9000 family (universally accepted quality standards in manufacturing). It has introduced the ISO 14000/14001 Environmental Management Systems (EMS) to provide a framework to implement processes to meet environmental goals.

The U.S. Green Building Council is the source of the Leadership in Energy and Environmental Design (LEED) rating system introduced as recently as 1998 and now used widely. These standards certify if a building project is environmentally friendly. The standards are based on a series of credits for sustainability of construction sites, water efficiency, renewable energy, recyclable materials, and indoor environmental quality, among other factors. Harkening back to the straightforward grading system of the credit rating agency, the LEED process awards certification levels ranging from certified, silver, and gold, to platinum. A comparison of buildings certified by LEED and Energy Star with comparable nongreen properties found that the environmentally certified properties performed better on a number of

---

6 R. Cantor and F. Packer, "The Credit Rating Industry," *Journal of Fixed Income* 5 (3) (1995): 10-34; and "The Crating Rating Industry," *Federal Reserve Bank of New York Quarterly Review* (Summer/Fall 1994): 1-26.

economic indicators, including energy costs, occupancy rates, sales prices and rental rates.<sup>7</sup> Real estate professors Gary Pivo and Jeffrey D. Fisher find that Energy Star energy-efficient buildings performed slightly better than noncertified properties as a result of lower utility costs. The study concluded that responsible property investments were no less safe than traditional investments and that investors can be socially responsible while also earning competitive financial returns.<sup>8</sup>

Several rating agencies are seeking to make the correlation between environmental, social, and governance (ESG) performance and financial performance. For-profit organizations such as KLD Research and Analytics screen companies on social performance using ESG indices that investors can integrate in their investment decisions. KLD maintains the database Socrates, which measures the social and environmental performance of corporations and allows investors to screen portfolios and track shareholder resolutions. Ratings of Innovest Strategic Value Advisors (now Risk Metrics) have been used to show that incorporating ESG factors into the investment decision-making process can enhance portfolio financial returns and identifies nontraditional sources of risk potential for investors.<sup>9</sup> Other agencies, such as Trucost Plc, help companies and investors measure and reduce their environmental impact, and understand how environmental performance correlates with the financial performance of portfolio companies. Trucost's "Carbon Footprint Analysis" has several components, such as calculating the carbon performance (expressed in financial terms) of each company in an investor's portfolio, and compares the fund's carbon costs against its benchmark.

Although the ratings issue is complex, turning something that is socially valuable into a financial structure is a means to attract new investors who need such instruments for a potential investment. Organizations modeled after Doctors Without Borders in the community development finance industry (in this case Wall Street Without Walls) have been able to do this. Wall Street Without Walls assisted the Community Reinvestment Fund (a large community development loan fund in Minneapolis) with the structure and process of getting a AAA/AA rating from S&P on a \$52 million pool of economic development loans. The process allowed for six new insurance companies to enter the market of socially responsible investments.

---

7 U.S. Green Building Council, "Newly Released Studies Confirm Energy Savings Significant in LEED, ENERGY STAR Buildings; Certified Buildings Outperform Peers in Sale, Rental, and Occupancy Rates." News release, April 3, 2008, Washington, DC.

8 G. Pivo and J. Fisher, "Investment Returns from Responsible Property Investments: Energy Efficient, Transit-oriented and Urban Regeneration Office Properties in the U.S. from 1998-2008." Working paper. (Boston: Responsible Property Investing Center, Boston College and University of Arizona, and Benecki Center for Real Estate Studies, Indiana University, October 2008, rev. March 2009).

9 Innovest Strategic Value Advisors, Innovest Strategic Value Advisors & the United Nations Principles for Responsible Investment (New York: Innovest, January 2007), available at [www.innovestgroup.com](http://www.innovestgroup.com).

*Community Reinvestment Act Ratings Align Social Objectives with Safety and Soundness*

For driving socially responsible investments, one of the more established devices in the United States is the Community Reinvestment Act of 1977 (CRA), which sought to increase bank financing in low-income and minority neighborhoods. The CRA is based on the premise that banks must serve the credit needs of the entire community—including low- and moderate-income areas—in markets in which they are chartered and take deposits. In addition, the CRA states that banks must accomplish this “consistent with the safe and sound operation of such institutions.”<sup>10</sup>

Federal regulatory agencies conduct CRA evaluations.<sup>11</sup> CRA ratings range from “substantial noncompliance” to “needs to improve” to “satisfactory” to “outstanding,” and can determine whether banks receive permission to merge or expand. The ratings are also made public, and they can influence an institution’s reputation. It is generally agreed that the CRA has substantially increased investment in low- and moderate-income communities. For instance, the Federal Financial Institutions Examination Council finds that in 2006, lenders in conjunction with CRA-eligible practices either originated or bought \$56 billion in community development loans, \$306 billion in small business loans, and \$12.5 billion in small farm loans. Mortgage data indicate substantial increases in lending to low- and moderate-income and minority communities attributable to the CRA, particularly after the lending measurements became more quantitative and less subjective in the mid-1990s.

The CRA provides further evidence that widely accepted social performance standards can attract capital. What is also clear is that, like the LEED environmental certification, activities that score high on social goals are good financial bets. The vast majority of institutions report that their CRA activities are profitable.<sup>12</sup> Several recent studies comparing CRA-covered mortgages and institutions with nonregulated mortgages and lenders find that few CRA-covered mortgages were subprime or “high-cost,” that is, of the type significantly more likely to default.<sup>13</sup>

---

10 G. Smith, M. Bush, and N. Paufve, “Measuring the Provision of Banking Services for the Underbanked: Recommendations for a More Effective Community Reinvestment Act Service Test,” Woodstock Institute Reinvestment Alert, 31 (2007): 1-10.

11 Depending on the type of depository institution, the regulatory agency conducting the CRA examine could be one of the following: the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, or the Federal Reserve Board.

12 M. S. Barr, “Credit Where It Counts: The Community Reinvestment Act and Its Critics,” New York University Law Review 13 (6) (2005): 515-651.

13 Elizabeth Laderman and Carolina Reid, “CRA Lending During the Subprime Meltdown,” Revisiting the CRA: Perspectives on the Future of the Community Reinvestment Act (Boston and San Francisco: Federal Reserve Banks of Boston and San Francisco, 2009); Lei Ding, Roberto Quercia, Wei Li, and Janneke Ratcliffe, “Risky Borrowers or Risky Mortgages: Disaggregating Effects Using Propensity Scoring Models.” Working paper (Chapel Hill, NC: UNC Center for Community Capital, 2008), available at <http://www.ccc.unc.edu>.

## Advancing Social Metrics Is Vital to the Industry

The targeted investing industry is growing as banks, insurance companies, public pension funds, foundations, and faith-based organizations are strategically focusing on investments that produce financial and societal returns. However, the issue of how to measure quality and success remains a central component to the development, and even the basic definition, of the industry. As such, the field must devise methods to ensure delivery of both financial and social returns. As LEED and CRA standards show, improved measures of the social returns can facilitate increased capital to the underserved markets. Such a social return is also evident in the CalPERS example, in which pension fund officers considered the social returns on the first California Initiative commitment of \$475 million in determining whether to make a second California Initiative commitment of \$550 million.<sup>14</sup> The question now is, how does the industry collectively transform the field through clearer social objectives and measurement standards?

Investors are always seeking data on their investments. The more institutional investors know about a potential investment's risk and return, the more readily they can make sound investment decisions.<sup>15</sup> Currently, investors are able to compare the financial returns using established financial benchmarks such as the "Property Index," created by the National Council of Real Estate Investment Fiduciaries for equity real estate, or the Thompson Reuters' "Private Equity Index" for venture capital, and "Barclays Capital Aggregate Bond Index" for fixed income products.

Likewise, the types of social investors and the way in which they monitor social returns will vary in line with their specific motivation for investing in underserved markets. A bank, public-sector pension fund, insurance company, foundation, or faith-based organization, each places a different value on the importance of measuring the social returns on their investment. The following four sections examine the questions four of these different investors ask in selecting investments on the basis of social returns (as identified in Table 2). The sections also examine investor motivations for seeking social returns, whether they be part of a policy, program, or in response to regulatory supervision.

### *Banks: Showing Leadership in Community Investing*

Banks have a long history of double bottom line investing and lending arising from their CRA obligations. Under CRA, the largest institutions (those with more than \$1.061 billion in assets) are subject to three tests: lending, services, and of particular interest to our subject, an investment test that considers investments that have community development as their primary purpose (within qualifying geographic areas). Although this is a broad definition,

---

14 Pacific Community Ventures provides analyses on social returns that measure outcomes such as job quality (e.g., wages, benefits, wealth building) green jobs, and capital flows to the underserved markets.

15 Hagerman and Hebb, "Balancing Risk and Return in Urban Investing" In "Managing Financial Risks: From Local to Global" EDS, Clark G., A. Dixon and A. Monk. Oxford University Press.

certain activities are automatically qualified, such as investments in Small Business Investment Companies (SBICs) and New Markets Tax Credits.

Discussions with representatives of large banks confirm the importance of CRA in driving financing of activities alternatively referred to as “underserved communities,” “double bottom line,” “community development investing,” or more explicitly, “CRA investing.” In general, institutions develop CRA plans with high-level geographic- and dollar-based objectives. Although different banks systematize their CRA investment allocation in different ways, institutions commonly divide their allocation between qualified housing investments and those available for other activities. The latter may include private equity for commercial real estate; private equity for business enterprises; investments in Community Development Venture Capital firms and SBICs; loans, deposits, program related investments or PRIs, or near-equity investments in nonprofit financial institutions; and historic and new markets tax credits. In short, they represent a variety of nontraditional financing activities. Proposed investments must meet the CRA criteria to “get in the room” for consideration.

Banks have generally no standardized protocols for measuring social benefits beyond what goes into CRA compliance. That is to say though they may gather information on job creation, job quality, sociodemographics of investees, direct and indirect benefits of a development, and so forth, it is not systematically collected, evaluated, tracked, reported, or benchmarked. Reasons for lacking such a system include the fact that CRA credit outweighs other considerations; varied investment types give rise to different pathways for social impacts; the subjectivity of social benefits; the lack of independently verifiable and auditable data; and costs in both time and money to collect robust information. Nevertheless, in the CRA banking community, there is interest in enhanced social metrics, particularly for upfront investment selection, clarifying and supporting an investment “theme,” streamlining due diligence, and facilitating benchmarking. Thus, enhanced social metrics would make it easier to evaluate investments vis-à-vis hurdle rates or alternatives, however, it is doubtful that even the most rigorously verified social impacts would ever result in financial return tradeoffs.

In a different model, BAML Capital Access Funds (BAMLCAF), a division of Bank of America, makes private equity investments on behalf of public pension fund investors in funds seeking to invest in underserved businesses.

Although the bank co-invests a portion of its own capital, CRA is not a focus for the BAMLCAF, which operates within the bank’s private equity division. The bank worked with its lead investors (CalPERS and CalSTRS) to develop a system for collecting data on social outcomes. Through a requirement in the side letter to the upfront investment agreement with each fund, the funds for each portfolio company report this information.

With funding from the Kauffman Foundation, the University of North Carolina Center for Community Capital manages and analyzes the data and coordinates with Bank of America in producing annual progress reports.

As of March 31, 2009, BAMLCAF has committed nearly \$309 million to 25 private equity and venture capital funds, which, by the end of 2007, had invested in nearly 120 companies. Seventy percent of these companies meet one or more of the funds' criteria for being underserved, including about one-third that are minority led, and approximately one-third that are located in low- and moderate-income census tracts. The average portfolio company employs 330 people.

Although there is no such thing as a "typical" investment, the various portfolio companies can be generally characterized as not fitting the mold of the traditional venture capital investment; that is, they are rarely found in Silicon Valley, and they range from traditional manufacturers to banks to entertainment to food service. For example, a BAMLCAF investment in a Mississippi-based manufacturer of healthy, rehydration beverages for industrial workers enabled this company to fund new equipment and expand into new markets, including internationally. Today the company employs more than 50 workers, with a full benefits package including health insurance, a 401(k) program with a match, and opportunities for advancement and on-the-job training.

More recently, BAML Capital Access Funds was selected by the New York Common Retirement Fund to manage a fund of funds focused on private equity managers who are female or ethnic minorities.

In venture capital investments, the early financial returns are often very low or negative owing to the "J-Curve effect," when funds have not yet exited on the investment and are absorbing high management fees.<sup>16</sup> CalPERS, one of the more transparent pension funds in their reporting, posts returns on its Alternative Investment Management Program, which includes the California Initiative. Since inception, the return on the California Initiative Fund I was 20 percent (as of 2007), with a one-year return of 70 percent (as of October 2007).<sup>17</sup> We now turn our attention to MassPRIM's economically targeted investments and their impact on the Commonwealth of Massachusetts.

### *Public Pension Funds: MassPRIM's Social Returns on Targeted Investments*

MassPRIM, the Massachusetts Pension Reserves Investment Management Board, targeted investments cross the asset classes of fixed income, equity real estate, and venture capital. The investments target 2 percent of its total assets (\$50.6 billion as of June 30, 2008). MassPRIM has committed \$230 million to Economically Targeted Investments (ETI) since the program's inception in 2003. The firm allocates these commitments across three asset classes and nine investment managers. Table 1 details how well each individual investment fund manager is performing on the social returns in terms of mortgages created, jobs created, affordable rental housing units, and small business or economic development loans.

---

16 T. Hebb, "California Case Study A: Private Equity CalPERS' California Initiative" Working paper 05-15. 1-28. (New York: Oxford University Centre for the Environment, 2005).

17 J. Mark, "CalPERS Alternative Investment Management Program: Investing in California's Underserved Markets." Power Point presentation to Inner City Economic Forum Summit, Philadelphia, October 18, 2007.

*Table 1. MassPRIM ETI Program's Impact on the Commonwealth of Massachusetts as of March 31, 2009*

<b>Firm</b>	<b>Asset Class</b>	<b>Mortgages</b>	<b>Jobs Created</b>	<b>Affordable Rental Housing Units</b>	<b>Small Business/Economic Development Loans</b>
Access Capital	Fixed Income	1311	300	201	13
Community Capital Management	Fixed Income	98	23	2200	2
AFL-CIO HIT Fund	Fixed Income	18	484	1155	0
Castille Ventures	Private Equity	0	85	0	0
Flagship Ventures 2004	Private Equity	0	498	0	0
Flagship Ventures 2007	Private Equity	0	79	0	0
Canyon Johnson	Real Estate	0	270	15	0
New Boston	Real Estate	0	360	0	0
Intercontinental	Real Estate	0	385	20	0
<b>Total</b>		<b>1427</b>	<b>2484</b>	<b>3591</b>	<b>15</b>

*Source: MassPRIM Executive Office, ETI Program Summary 1st Quarter 2009, page 2.*

The ETI first quarter summary report notes, “While each of the three asset classes in our ETI program has a different time horizon, the overall ETI program is meeting expectations. As the Board is aware, due to the nature of both Real Estate and Private Equity investing, the full benefits to the Commonwealth of Massachusetts will not be fully realized for several years. That said, it is estimated that over 1,400 mortgages, 3,500 affordable rental housing units, 2,400 jobs, and 15 small business/economic development loans have been, or will be, created across all three assets classes.”<sup>18</sup>

MassPRIM requires external fund managers to deliver and report on the basic social returns in quarterly reports. For selection, fund managers take part in a rigorous “request for proposal (RFP)” process that identifies a manager’s ability to invest in the underserved markets and perform on both the financial and social returns (see Table 2). The reports provide an initial snapshot of how fund managers are performing on the ancillary benefits. In the case of Access Capital, a fixed-income asset manager, the fund provides more detailed reporting modeled after CRA guidelines. Pension funds find the reporting straightforward. In Access Capital’s case, as of March 31, 2009, their program created 1,300 mortgages, 300 jobs, 200 affordable housing units, and 13 small business economic development loans.

<sup>18</sup> MassPRIM Executive Office, ETI Program Summary 1st Quarter 2009, page 1.



### *Foundations and Insurance Companies: Supporting Their Missions and Improving Quality of Life*

A growing number of foundations are also leaders in targeted investing, or as they call it, “mission investing.”<sup>19</sup> The Annie E. Casey Foundation established a formal “Social Investment Program” in 2002, and in 2004, the trustees allocated \$100 million (approximately 3 percent of the endowment) to social investments to benefit both the foundation’s endowment and its programmatic activities. The F.B. Heron Foundation, a leader in mission investing, commits 35 percent of its endowment to mission investing (as of year-end 2008). It intends to increase this share to 50 percent by the end of 2009. Both foundations specify their social objectives, in line with programmatic interests, and rigorously track the social returns (see Table 2).

Insurance companies engage in targeted investing as well. Metlife’s social investment program improves quality of life through housing, education, economic and community development through investments. They request financial reporting of their fund managers as well as reporting on the ancillary benefits that detail basic social impacts.

### *Toward a Unified Measure of Social Value*

Each of these investors places a value on the social returns, yet perceives social value from a different perspective. The value allocated depends on the overall objective of the investor’s targeted investment policy. Table 2 offers a snapshot of the issues important to institutional investors, categorized by investor type, objectives, and key questions on potential social returns. Investors may have differing social objectives, yet they universally would like to see better metrics. Although there is still a lack of convergence, the field is making progress.

## **Providing Social Metrics**

A growing number of service providers, academic centers, and trade associations are working to develop measures of social and environmental outcomes (see Table 3).

The Community Development Venture Capital Alliance, a trade association, moved the industry a step forward by creating a toolkit of standards for measuring social benefits. The toolkit features a social metrics template for venture capital firms. The Opportunity Finance Network, which supports the Community Development Financial Institutions (CDFI) industry, created the CDFI Assessment and Rating System (CARS). Independent, third-party ratings of CDFIs are performed that are specifically geared to “current and prospective investors and donors in CDFIs.” Financial strength is rated on a scale of one to five, while “impact

---

<sup>19</sup> Mission investing seeks opportunities to align a foundation’s financial investments with the mission of the organization, while maintaining long-term targeted financial returns. At its core, investor intent drives mission investing, and it focuses on the dual objectives of furthering programmatic goals and earning financial returns. The term “mission investing” covers market rate investments that support program goals; and program related investments structured to create specific program benefits while earning a below-market return. The Boston College “More for Mission Campaign” includes a leadership committee (40 foundations, representing \$27 billion in assets) that are committed to mission investing. See <http://www.moreformission.org> for more information.

*Table 2. The Investment Decision-Making Process and Social Reporting Guidelines*

*Source: Hagerman: Based on data in 2008 ETI RFPs, MassPRIM, NYCERS, Vermont State Retirement System, senior staff (Spring 2008).*

<b>InvestorType/ Examples</b>	<b>Objectives</b>	<b>RFP questions relevant to targeted performance on social returns or Key impacts identified in the investor's social investment guidelines</b>	<b>Reporting</b>
Pension Funds: MassPRIM (www.mapension.com)	Economic development in the state of Massachusetts.	1. Demonstrate that your investments will target a "capital gap" where there are likely to be underserved markets. 2. Demonstrate that your firm is capable of tracking investment performance and the collateral benefits of your investments. 3. Demonstrate that your firm will invest over 50% of PRIM's investment in the portfolio in the Commonwealth of Massachusetts. 4. What unique attributes does your firm or your product have which distinguish it from its competitors in the fulfillment of this assignment? 5. Describe how your product differentiates itself from those of PRIM's current managers. What role would your portfolio play in PRIM's ETI Program?	Quarterly report detailing financial and social returns
Pension Funds: NYCERS (www.comptroller.nyc.gov)	Fill capital gaps in New York City; i.e. offer financing in areas that are underserved by existing market mechanisms. The 2008 RFP, was originally issued in May 2003, has been amended and re-issued to solicit equity-based investment proposals in addition to debt-based proposals.	Proposed Impact on low-moderate and middle income neighborhoods and populations or women and minority populations in New York City must be detailed. RFP asks potential firm to describe the marketing plan and how the fund manager will source product asking: Will this program differentiate itself from others in this market? What is the value added to this market by a pension fund economically targeted investment? The Comptroller's Office and systems also notes they want to see City business opportunities available to firms with strong Equal Employment Opportunity programs, including those with significant woman and minority-ownerships. Describe the potential collateral benefits for NYC. Specify (and quantify to the extent possible) the demographic or economic sector expected to benefit. Identify any collateral costs (e.g. sectors or population groups likely to be disadvantaged by selection of the proposal). Describe your lending or investment experience in low-moderate or middle-income neighborhoods or individuals, including experience in residential lending (multifamily, single family), commercial lending (real estate, business loans etc.) and community facility lending.	Managers must provide reports on a regular basis. The content and timing of the reports will be determined by the particular features of the program(s) established via the RFP and may include monthly and/or quarterly reports.

Table 2, continued

<p>Pension Funds: Vermont Pension Investment Committee (www.vermont-treasurer.gov)</p>	<p>Fill capital gaps in Vermont; offer financing not currently available through existing mechanisms.</p>	<p>Provide specific quantitative and/or qualitative economic benefits to the state of Vermont. Proposals must identify the capital gap to be filled, the sector of the market that is not efficiently served by lenders, or investors, and clearly demonstrate the collateral benefits to the State of Vermont. Investments must provide collateral economic benefits that enhance quality of life and promote economic development and activity to the targeted area -- Vermont. Collateral benefits may be quantitative (e.g. the investment results in additional affordable public housing units produced) or qualitative (e.g. the investment results in improved public facilities or environmental benefits). Identification of capital gaps includes for example: Low to moderate income quality housing investment: funding for managed mortgage programs suitable for first time and other underserved borrowers; entities lending to affordable housing projects. Loans or equity capital funding for small to medium size businesses: Venture Capital, Mezzanine Debt Funds; debt and equity expansion capital; SBIC lending programs and purchase of SBA, loans other lending or investing to promote the expansion of environmentally attractive business technology and environmental engineering.</p>	<p>The quality of controls and reporting systems (including audited financials, risk management systems and reports to investors); must be submitted in RFP process and set forth once selected.</p>
<p>Foundations: Annie E. Casey Foundation (www.aecf.org)</p>	<p>Foundation's mission is "place-based" in that the foundation supports comprehensive strategies in specific neighborhoods and communities. Seeks to strengthen support services, social networks, physical infrastructure, employment, self-determination, and economic vitality in distressed communities.</p>	<p>Across the three types of investments (Mission-Related Deposits, Program Related Investments, and Mission-Related Investments) the Annie E. Casey Foundation Social Investment Program measures the impact of its investments on two levels as noted in their program guidelines: 1. Population-level impact focus on community-wide improvements. These can include increased access to services, reductions in poverty, public policy that responds to the needs of families, improved infrastructure, increases in jobs, homeownership, earnings etc. In many cases, the Foundation partners with research institutions to collect objective data on macro-level outcomes in targeted neighborhoods. 2. Deal-specific impact is written into the covenants of individual investment agreements. These are established on a case-by-case basis, depending on the investee organization's competencies and include quantifiable targets, such as specific numbers of affordable housing units developed, small businesses financed, jobs created etc. These impacts are measured on an ongoing basis as part of each organization's reporting requirements.</p>	<p>Reports vary depending on investment and as requested by Foundation.</p>

Table 2, continued

Foundations: F. B. Heron Foundation (www.fbheron.org)	Promote one or more of the following “wealth-creation” strategies for low-income families and communities: advancing home ownership, supporting enterprise development; increasing access to capital; and reducing barriers to full participation in the economy by providing quality child care.	Mission-related investments may take the following forms as noted in their website guidelines: -Program-related investments, typically low-interest senior or subordinated loans or equity-like investments to nonprofit or for-profit organizations whose work closely corresponds with the Foundation’s programmatic interests; -Market-rate insured deposits in low-income designated credit unions or community development banks; -Other mission-related investments including, but not limited to, private equity and fixed-income securities offering a risk-adjusted market rate of return with substantial social benefits to low-income families and communities. When reviewing a potential mission-related investment, foundation staff conduct a comprehensive review of the prospective investee’s program achievements, governance, management and program competencies, financial health, and future plans in order to judge its ability to meet the terms of the investment. The foundation notes that as is the case with any investor, the Foundation will balance the risks of a given investment against its potential financial and social returns. The foundation makes investments across three wealth creation strategies that best support their mission and seek social impacts across these three strategies: Home Ownership (Advancing home ownership in low and moderate-income communities), Enterprise Development (Supporting enterprise development in distressed communities) and Access to Capital (Increasing access to capital and preserving assets for low-income families and communities).	Reports vary depending on investment and as requested by Foundation.
Insurance Company: MetLife	Seeking market-rate investments to benefit community and opportunity, unlike banks no CRA like legislation imposed.	Guideline that governs investments with language to the extent of, “The officers of Metlife can make community development investments to the extent that they benefit economic vitality, education, and minority and women-owned enterprises.”	Reporting to Board two times a year that includes social impacts. Also reports to the state trade association, the Life Insurance Council of New York, Inc. (LICONY)
Banks	Revitalize underserved areas in markets where they lend in compliance with the Community Reinvestment Act.	CRA ratings from outstanding to noncompliance based on factors such as borrowers of income levels and by geography.	As determined by CRA reporting guidelines.

performance” is rated on a scale of AAA to B, on the basis of the CDFI’s effectiveness in meeting its mission goals.

Specialized investment vehicles are also creating new metrics and reporting products. The National Community Investment Fund (NCIF) has developed a methodology for identifying depository institutions that have a community development mission. NCIF coined the term “community development banking institutions” (CDBIs) for financial institutions that have a community development mission and generate sound financial returns. The NCIF “social performance metrics” assists investors in the investment decision-making process by helping them identify banks with a high proportion of home lending to low- to moderate-income communities (development lending intensity) and institutions that are targeting a significant share of their branches to these areas (development deposit intensity).<sup>20</sup> Pacific Community Ventures, a nonprofit dedicated to developing and investing in businesses providing economic gains to low/moderate income communities in California, provides analyses on social returns that measure outcomes such as job quality (e.g., wages, benefits, wealth building), green jobs, and capital flows to the underserved markets. Building on their experience in documenting the social returns of their own activities, they perform third party evaluation of social returns on private equity investments, including an annual evaluation of the community outcomes of CalPERS’ California Initiative private equity portfolio.<sup>21</sup>

Academic centers are a growing resource center for advancing the field. On the venture capital side, as mentioned previously, the Center for Community Capital at the University of North Carolina at Chapel Hill collaborates with the Banc of America Merrill Lynch Capital Access fund-of-funds (BAMLCAF) to collect and evaluate social metrics. The Center for Business and Economic Research at the Louisiana State University, Shreveport, is also attempting to measure impact on venture capital investments.

Among real estate organizations, the Boston College Responsible Property Investing Center (RPIC), sponsored by the Boston College Institute for Responsible Investment, offers resources for responsible property investors. The center, under the leadership of David Wood and in collaboration with the University of Arizona, brings together real estate developers, lenders, fund managers, and investors to share practices, take part in research, and foster professional networking. Social and environmental returns in real estate include affordable and workforce housing, energy efficiency, fair labor standards, smart growth, brownfield redevelopment, and others. Metrics may include figures such as housing units created, incorporation of LEED standards for new construction, Energy Star benchmarking, or distance from public transit centers.

---

20 Saurabh Narain and J. Schmidt, “NCIF Social Performance Metrics: A Quantitative Approach to Measuring the Social Impact of Banks and Thrifts, and to Investing Capital in the Community Development Banking Sector” (Chicago: National Community Investment Fund, 2008).

21 See *Pacific Community Ventures, “Executive Summary of Social Return on Investment” and “CalPERS’ California Initiative—Impacting California’s Underserved Communities”*, available via <http://www.pacificcommunityventures.org/insight/>.

The field is growing quickly with initiatives such as the Rockefeller Foundation's Impact Investing Collaborative (RIIC), which seeks to build a system to promote the flow of impact investment into broader areas of public interest through, for example, the Global Impact Investing Network (GIIN). In addition, the Global Impact Investing Ratings System (GIIRS) aims to assess social and environmental impacts of companies and investment portfolios with ratings similar to the conventional credit risk ratings described earlier of Moody's and S&P. GIIRS will rate the impact of sustainability and mission-focused venture capital and private equity funds. Another initiative is IRIS that aims to set a common framework for defining, tracking, and reporting the performance of impact capital. The development of the IRIS taxonomy is being led by B-Lab, the Acumen Fund, and the Rockefeller Foundation. RIIC has supported research and publications such as "Investing for Impact" and the "Catalog of Approaches to Impact Measurement."<sup>22</sup> The latter catalogs different impact measurement systems (classified as ratings, assessment, and management). Examples include ratings systems such as LEED; assessment systems such as Pacific Community Ventures Social Return on Investment; and environmental impact management systems such as Trucost.

More traditional investment consultants are also emerging to assess potential mission-related investments for their foundation clients. In February 2008, Cambridge Associates announced the formation of the Mission Investing Group with their foundation partners, the Annie E. Casey Foundation, the F.B. Heron Foundation, and Meyer Memorial Trust. This development exemplifies how rapidly the field is growing, with traditional investment consultants now engaged in seeking social impact investments.

In summary, in response to investor demand for evidence of the social benefits from targeted investing, advisory firms, university research centers and trade associations have begun to create tools and services. While these innovations are promising, the field is far from converging on consistent measurement standards.

## Moving Forward: Challenges and Recommendations

Although there is value in capturing the social returns of targeted investments, financial returns remain first and foremost for investors. In many respects, measuring social impact is a chicken and egg dilemma. Improved and more widespread social impact measurement will only develop to the extent investors require it. However, investor interest hinges on developing a more clearly defined and measurable investment theme. The environmental field is further along in creating benchmarks and standards metrics, with nationally recognized

---

22 See Monitor Institute, "Investing for Social and Environmental Impact: A Design for Catalyzing an Emerging Industry" (Cambridge, MA: Monitor Institute, January 2009), available at <http://www.monitorinstitute.com/impactinvesting/index.html>; S. Olsen, B. Galimidi, and Social Venture Technology Group, *Catalog of Approaches to Impact Measurement, Assessing Social Impact in Private Ventures (Version 1.1)* (New York: Rockefeller Foundation Impact Investing Collaborative, May 2008), available at [www.svtgroup.net/pdfs/RIICcatalog](http://www.svtgroup.net/pdfs/RIICcatalog).

*Table 3. Types of organizations providing social metrics*

*Source: Firm websites, senior staff (Spring 2008)*

<b>Type of Organization/ Examples</b>	<b>Ven- ture Capital</b>	<b>Real Estate</b>	<b>Debt — Housing, Communi- ty Loans</b>	<b>Measures Social &amp; Green Returns</b>	<b>Measures Financial Return</b>	<b>Example Client &amp; Objectives</b>
Nonprofit Ad- visory Services Provider: Pa- cific Community Ventures	X			X	X	Varies by investor. Pension fund client example: CalPERS: Objective 1: Providing Capital to areas that have historically had limited access to institutional equity capital Objective 2: Employing workers living in economically disadvantage areas Objective 3: Supporting woman and minority entrepreneurs and managers (PCV/ CalPERS, 2007).
Nonprofit Advisory Ser- vices Provider: SJF Advisory Services	X			X		Partnerships with foundations that request detailed report- ing based on their program- atic directives (see table 1) outcomes/impacts evaluated includes: employee benefits -- health benefits, wealth creation benefits -- stock options plans, women and minority ownership, training towards homeown- ership, educational programs -- workforce innovation, clean- tech innovation, and amount of additional investment leveraged.
Nonprofit Advisory Service Provider: Coast- al Enterprises Inc. (CEI)	X		X	X	X	Foundations: CEI in col- laboration with Shorebank Enterprise Cascadia and nine CDFIs created a triple bottom line scorecard. CEI measures outcomes through an "EcoTag Environmental Agreement" includes incentives such as a reduced rate on loans as a reward for a high environmental score such as reductions in energy consumption and green house gas emissions.
For-profit fund manager: Ac- cess Capital			X	X	X	Banks: serving low and moder- ate income communities that receive CRA credit. Pension Funds: broadly targeted invest- ment and like CRA modeled social reporting on returns.

Table 3, continued

Academic Center: UNC-Chapel Hill, Center for Community Capital	X			X	X	Kauffmann Foundation/BACAF example: Companies owned by women and minorities, located in/employing residents of LMI areas with limited access to capital, serving minority markets.
Academic Center: Boston College Responsible Property Investing Center		X		X	X	Resource center providing real estate metrics for industry covering for example: energy-efficient building management, incorporation of LEED standards for new construction, Energy Star benchmarking, transit-oriented development, work force housing, and land conservation.
Specialized Consultants and For-profit Fund Managers in Triple Bottom Line Industry reporting on social returns: Bay Area Family of Funds, CEI Ventures, Cherokee Investment Advisors, Double Bottom Line Investors, Economic Innovation International, Enterprise Community Partners, Imprint Capital, Strategic Development Solutions (SDS), SJF Ventures, USA Fund.	X	X		X	X	Banks, insurance companies, foundations, pension fund, faith based pension funds. Varies by client and mission.



Table 3, continued

Trade As- sociations: Community Development Venture Capital Alliance, Oppor- tunity Finance Network (CDP Project), Wall Street Without Walls.	X		X	X	X	Focus on mission of serving low to moderate income areas and financing woman and minority owned firms.
Government: Community Development Financial Institu- tions (CDFIs)	X		X	X	X	Focus on mission of serving low to moderate income areas and financing woman and minority owned firms. Receive CRA credit.
Individual investors: Public pension funds, labor pension funds, church pension funds, foundations, banks, insurance companies.	X	X	X	X	X	Varies by investor, mission, and dedicated staff (e.g. serving low-moderate income employees, environmental goals, promotion of woman & minority enterprises, property investments that support union labor, targeted investments in state, see table 1) Banks (CRA credit). Insurance companies reporting to LICONY.

benchmarks such as LEED, for example. Their advances are perhaps owing to the clear and direct correlation between quality environmental management and better financial performance on the first bottom line. Metrics on the social returns are less straightforward, yet the correlation between the financial and the social can be made evident, as we have seen in some cases. Among economic development metrics, CRA demonstrates how social benefits can be linked with financial objectives, via the safety and soundness mandate.

In considering how to increase capital flows to the underserved markets, we highlight some of the central questions and issues from an investor's perspective. Four major challenges lie ahead for the industry. First, some fund managers may resist social return reporting owing to confidentiality concerns and the additional work involved. Second, reporting by fund managers raises questions of data accuracy and potential bias in reporting. Third, practical matters arise, including who pays for the evaluations, frequency of reporting, and so forth. Fourth, standardizing analysis is a challenge. On the one hand, investments are varied and are not created equal in their social impacts. On the other hand, investor interests are also divergent; that is, everybody wants customized social outcomes measurements. The question for the industry is how to realize the value from the information through meaningful benchmarks and the practicality of creating standards.

Despite these challenges, institutional investors we interviewed for this research expressed a shared desire for improved indicators of the social returns of investments. As one interviewee said, "Difficulty in measuring is not an excuse to not ever measure." The applications envisioned for such indicators were of a practical nature. They expressed interest in tools that could help in front-end screening and in distinguishing between investments that truly deliver double or triple bottom line results versus those that just pay lip service to the social bottom line. There was some interest in metrics that could assist in investment selection, but only in cases in which competing opportunities offered "identical" financial returns and the social commitment could serve as a differentiator.

Thus, interviewees argued for a rigorous screening process, as a careless one could do more harm than good. This lesson was recently learned by institutional investors in the subprime mortgage market who deferred to financial ratings provided by the big three rating agencies, which ultimately proved flawed. (Although it is possible that greater attention to the negative social impacts of the underlying activities might have given investors warning about the financial unsustainability of the investments.)

But perhaps the most fundamental opportunity identified is using social metrics to help define the space. As one interviewee put it, "Many want to answer, 'does it work?' [but first one must] also answer 'what is it?'" This comment suggests that the adage "you are what you measure" might also apply to this developing investment sector.

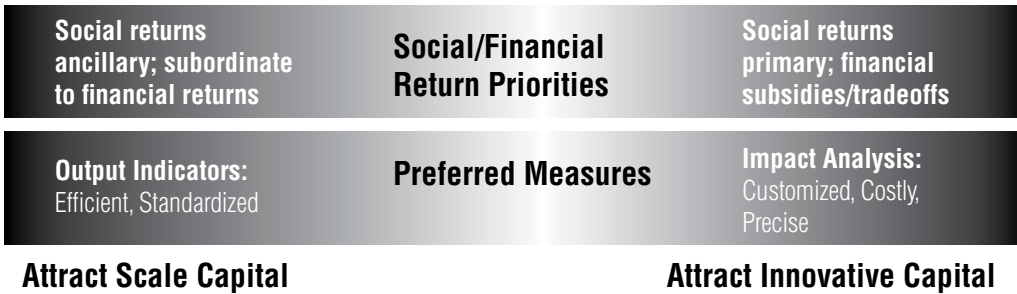
In raising these challenges and opportunities, we consider realistic next steps to advance the art of measuring the social returns and thus increasing capital to the underserved markets. We recognize that developments will be incremental. We hope to facilitate the exchange of information on the topic that includes information sharing by investors on

social return evaluation resources and common questions to fund managers. An insight we gained from this process of information exchange is that measurements can take different forms for different purposes and audiences.

There currently exists a tension between calls for, on the one hand, development of such a ratings or high-level classification system, and on the other hand, undertaking deeper, more meaningful levels of social impact analysis. Champions of the latter would argue that data that are too high level do not properly capture the social return and broader impact of each investment, and do not allow investors to distinguish those investments with greatest impact.<sup>23</sup>

We recognize that the value placed on this process varies by investor. Rigorous and labor-intensive impact analyses conducted by mission driven funds have proved useful in strengthening theories of change and attracting subsidized and highly motivated financial and human capital. However, such depth of analysis does not necessarily attract scaled, market-rate funding from institutional investors such as banks and pension funds, who require easier-to-gather data. The following diagram illustrates (from left to right) how the social metrics have increasingly more specific input in the investment decision-making process.

Chart 3.



Source: J. Ratcliffe, “Who’s Counting? Measuring Social Outcomes from Targeted Private Equity,” *Community Development Investment Review* 3 (1)(2007): 23-37.

Thus, for a pension fund, for example, a ratings process could be helpful in the due diligence and investment decision-making process, similar to tools used for traditional investments, such as the Global Performance Investment Standards (GIPS). A ratings process for both the financial and social performance of targeted investments could provide a score (similar to CRA’s scale from “outstanding” to “noncompliance”) or signal the ability of a manager to perform on not only on the financial but also the social returns.

23 See, for example, the arguments made by Rutgers Professor Julia Sass Rubin: Rubin, J. (Forthcoming). All Developmental Venture Capital Is Not Created Equal: How the Rhetoric of Emerging Domestic Markets Can Hurt Distressed Communities. In *Enterprise and Deprivation: Small Business, Social Exclusion and Sustainable Communities*. Alan Southern (Ed.) New York, NY: Routledge Publications.

The following model provides a path for moving from scale reporting and classifications that facilitate capital flows toward custom measurements of true social impact. The six steps that an investor can take in identify, reporting on, and allocating capital to targeted investments by asset class include:

1. Define an investment theme or investment policy specific to an institutional investor's unique objectives (for example: targeted investing for public pension fund investors, environmental sustainability for environmental foundations, community development for foundations, banks or insurance companies),
2. Screen investments to "get in the room" for consideration. (Table 2 outlines some of the questions asked in the RFP process),
3. Report on social and environmental outcomes through third-party evaluators and tracking and documenting clearinghouses,
4. Benchmark targeted investments' social or environmental performance for a particular investment product with certification processes such as the LEED example in real estate, in the same way financial benchmarks are set, for example, by the Barclay's Capital Aggregate Bond Index for community development fixed income products.
5. Evaluate investment products through a ratings process or high-level classification system that allows for comparable measurement of impact across investment products (analogous to a Moody's credit risk rating)—for the purpose of allocating additional resources within each asset class.
6. Accurately quantify "impact" to drive innovation and impact policy - getting to the "theory of change".

We have argued here that to increase the flow of capital to private equity in underserved markets, investors need better social measures based on an investor's targeted social objective. In doing so, we explored the value investors place on the evaluation processes and how more rigorous systems could lead to greater investment. We observe that the more active an investor becomes in "double-bottom line" investing, the more they demand better social measures as a condition for investing. We also see that as social measures improve it enables investors to differentiate between two investments with similar financial track records, and that the social measures become the deciding factor for the investor.

Clearly, social and environmental metrics are increasingly important, and sharing resources, asking consistent questions, and engaging investors in the process will continue to advance the field. Although each type of institutional investor places a different value on metrics, the demand for social reporting is increasing. It may be a long time (if ever) before social impact metrics are so reliable that investors are willing to trade off financial returns (nor is this feasible for certain investors), but that is not the goal of this effort. Rather, the goal is to extract the value of the social return on investments in order to increase capital flows, thus promoting entrepreneurial activity and sustainable economic development in traditionally undercapitalized markets.

*Lisa A. Hagerman, Ph.D., is the director of the More for Mission Campaign Resource Center at the Boston College Institute for Responsible Investment. She is also affiliated as a research fellow with the University of North Carolina at Chapel Hill, Center for Community Capital and the Oxford University Centre for the Environment. In July 2008 she completed her appointment as a research fellow at the Labor & Worklife Program, Harvard Law School, working on the Pension Funds & Urban Revitalization Initiative funded by the Rockefeller and Ford Foundations. Lisa Hagerman was previously a Vice President of Economic Innovation International, a Boston consulting firm that builds privately capitalized community equity funds. Prior to her consulting work, Ms. Hagerman was with Wells Fargo Bank, San Francisco, as assistant vice president in the Government Relations group and also worked for Citibank, New York, for seven years in the Latin American Marketing Division. Lisa Hagerman completed her doctorate in economic geography at the University of Oxford. Ms. Hagerman received her B.A. from Bucknell University and her M.A. in political science from the University of North Carolina at Chapel Hill.*

*Janneke Ratcliffe is Associate Director for the UNC Center for Community Capital, which she joined in 2005, bringing 20 years experience in financial services and community development finance. She has served as executive director of a small business lending nonprofit. She spent ten years in GE Capital's mortgage subsidiary in risk management, product development and strategic planning. She worked for seven years at one of the country's leading community development financial institutions helping to launch a multi-billion dollar secondary market for affordable home loans and developing a new funding source for commercial lending through the New Markets Tax Credit Program. Throughout her career, she has worked to facilitate the flow of financial services to low-income and minority households and under-capitalized communities.*

### ***Acknowledgments***

We would like to thank the pension funds, foundations, banks, and insurance company interviewed for their valuable time and insights. This article is a shortened version of a paper written in July 2008 with the support of the Ewing Marion Kauffman Foundation. None of the above should be held accountable for the views expressed, errors, or omissions.

## NCIF Social Performance Metrics:

Increasing the Flow of Investments in Distressed Neighborhoods through  
Community Development Banking Institutions

***Saurabh Narain and Joseph Schmidt***

*National Community Investment Fund*

*Is it possible to develop a practical methodology that differentiates community development banking institutions from all other banks and thrifts?*

*Can we create a direct correlation between a bank's community development activities and the level of investor support that it receives, resulting in a "reward" tied to the developmental impact of these institutions?*

*Can we actually measure this social return for investors and stakeholders and combine social return with financial return to generate a total return that is higher than the total return achieved from mainstream investments?*

With these questions, the National Community Investment Fund (NCIF) began developing a methodology for identifying depository institutions whose mission is to serve the financial needs of residents, entrepreneurs, and businesses in low- to moderate-income communities. The NCIF Social Performance Metrics<sup>SM</sup> methodology uses publicly available census data, branch location data, and mortgage loan data to measure the social impact of banks and thrifts. After identifying banks that operate in and serve low-income communities, NCIF and other investors are supporting these Community Development Banking Institutions (CDBIs)<sup>1</sup> with deposits and other funding. (Disclosure: Both authors are representatives of NCIF.)

Community Development Banking Institutions serve the needs of low-income communities by providing access to much needed depository services and loan products, and they serve an institutional role in improving the economic health and quality of life in these economically vulnerable areas. Although most CDBIs refrained from the irresponsible lending practices associated with the current recession, they are nevertheless hit hard as their customer base is ravaged by rising unemployment and foreclosures, and as budget-strapped governments cut back on social services. Now is the time to combat this decline by acting quickly to stimulate the economy in distressed areas. To accomplish this, NCIF is working with socially responsible investors to identify and support CDBIs as intermediaries

---

<sup>1</sup> NCIF coined the label "Community Development Banking Institution" to denote banks, thrifts, and credit unions that generate superior economic development effects and reasonable financial return. Although these CDBIs, walk, talk, and look like certified Community Development Financial Institutions (CDFIs), they may or may not be certified as such. NCIF hopes that eventually these institutions will become certified and expand the asset class of CDFIs.

that can quickly and efficiently get investment dollars to where they are needed most: in the hands of the small businesses and entrepreneurs located throughout the nation.

Industry leaders have responded positively to this new methodology. Luther Ragin, Jr., vice president of investments at the F. B. Heron Foundation, said that “these metrics are an important step in the creation of consistent, verifiable, and cost-effective measures of social impact by commercial banks. They allow us to analyze social and financial return in a rigorous way.”<sup>2</sup> NCIF looks forward to working alongside the investor community to move the needle of community investing and translate this support to the benefit of low-income communities.

## The Growth of Socially Responsible Investing

According to the 2007 Report on Socially Responsible Investing Trends in the United States, investment in socially responsible organizations is growing at a rapid pace. Between 2005 and 2007, assets in the category of socially responsible management grew 18 percent to \$2.7 trillion. These assets are divided into three broad categories of screening, shareholder advocacy, and community investing. However, among these three categories, only \$25.8 billion (0.9 percent) is dedicated to community investing. This is unfortunate, as the current recession is severely affecting low-income individuals and low-income communities. A greater level of community investing can generate needed economic growth and job creation.

Why are the amounts flowing into direct community investing so small relative to the size of the industry? And why is the volume so small relative to the stated desire to spur economic development through investor dollars? Proposed reasons include a lack of an investment “product” that provides market returns and economic development impact; a lack of an investment “vehicle” that can facilitate investments; and a lack of a “metric” to measure and communicate the economic development impact of the investment.

However, contrary to assumptions, a readily available investment product exists in the form of deposits in community development institutions that provide a safe, market rate return with an acceptable level of risk yet with significant positive impact in distressed communities. Investors can deposit funds in FDIC-insured, domestic, CDBIs (the vehicle), which in turn invest in low- to moderate-income communities. Once the investors become comfortable with the CDBIs, other forms of higher impact funding (such as debt and equity) can also be provided. These mission-oriented banks and thrifts (referred to as banks in this article) spur growth in local economies by increasing access to responsible financial services in underserved communities and by establishing partnerships that result in sustainable economic development.

---

2 See Saurabh Narain and Joseph Schmidt, “NCIF Social Performance Metrics: A Quantitative Approach to Measuring the Social Impact of Banks and Thrifts, and to Investing Capital in the Community Development Banking Sector,” White paper (Chicago: NCIF, 2008), available at [www.ncif.org/images/uploads/NCIF\\_SPM.pdf](http://www.ncif.org/images/uploads/NCIF_SPM.pdf).

As Federal Reserve Board Chairman Ben Bernanke stated in a recent speech, “The current crisis points to the importance of a strong network of healthy community-based organizations and lenders. As many communities struggle with rising unemployment, high rates of foreclosures, and vacant homes and stores, these organizations lead efforts to stabilize their neighborhoods. Rather than pulling back, CDFIs are introducing new products and programs to help communities respond to the crisis.”<sup>3</sup> In contrast to large banks that are scaling back their lending, many CDBIs continue to offer innovative products and services tailored to the specific needs of their customer base.

By identifying, supporting, and communicating the significant impact of CDBIs throughout the country, NCIF is working to highlight these attractive targets for socially responsible and mainstream investment. NCIF hopes to create a virtuous cycle of high impact community investing (See Figure 3), leading to increased financial support of an often overlooked investment class that is deeply involved in the economic development of disadvantaged communities. NCIF’s Social Performance Metrics and the model CDBI framework provide a formal methodology and proxy for evaluating the social performance of CDBIs; investors can overlay their own metrics and preferences on top of this. The “investment allocation methodology” then provides a mechanism to allocate assets into CDBIs that meet the programmatic and geographic objectives of the investors.

While measurement of social performance using credible metrics is important for socially responsible investors, it is as critical for the investors to demonstrate that they will reward the CDBIs as they generate more impact. As impact increases from “x” to “2 times x” the CDBIs should expect to get more funding from the investors.

### **Identifying CDBIs as an Asset Class**

Community Development Banking Institutions are “double bottom-line” institutions with proven track records of directing their products and services to the most economically vulnerable communities. By doing so, they serve as a necessary alternative for consumers who are forced to rely on predatory lenders, check cashers, and pawn shops. An investor in CDBIs is providing critical capital that will be immediately put onto the street. Whether it is providing a local entrepreneur with a small business loan or stabilizing disadvantaged neighborhoods by lending to mom and pop real estate developers, these banks are doing more than completing one-off transactions; they are serving an institutional role in the ongoing development of their communities.

The most recognizable CDBIs are certified as Community Development Financial Institutions (CDFIs) by the CDFI Fund. The CDFI Fund is a division within the U.S. Department of the Treasury that promotes economic revitalization and community

---

3 Federal Reserve Board Chairman Ben S. Bernanke, “Community Development Financial Institutions: Challenges and Opportunities,” at the Global Financial Literacy Summit, Washington, D.C., June 17, 2009. Available at: <http://www.federalreserve.gov/newsevents/speech/bernanke20090617a.htm>.



development by investing in and assisting financial institutions that display a proven mission of community development. However, as of July 1, 2009, only 63 of the 8,255 banks active in the United States were certified as CDFIs.

As not all CDBIs are certified by the CDFI Fund, it is necessary to identify them using other means, both quantitative and qualitative. To quantify community development, NCIF created the social performance metrics methodology. As noted above, the metrics use publicly available data to identify institutions that locate a high percentage of their activity in low-income areas. In addition, NCIF created the model CDBI framework to qualitatively assess a bank's impact on community development. The framework provides potential investors with information on an institution's operation to help ascertain whether an institution has a community development orientation.

### *Quantitatively Identifying an Asset Class: The NCIF Social Performance Metrics*

To measure the social impact of banks and thrifts, the social performance metrics analyze the share of an institution's home lending and branches located in low-income areas.<sup>4</sup> NCIF<sup>SM</sup> has created a full suite of social performance metrics that have proven valuable to investors. As an example, according to Scott Budde, Managing Director of Global, Social, and Community Investing at TIAA-CREF Asset Management, "the NCIF metrics are proving a helpful tool for understanding the relative strategies and outcomes of CDFIs. The addition of systematic, objective data to an otherwise relatively subjective process is a major advance both for TIAA-CREF and the SRI industry."<sup>5</sup>

The first core metric in the social performance metrics is Development Lending Intensity (DLI) and is calculated using an institution's Home Mortgage Disclosure Act data. This DLI-HMDA metric assesses the percentage of an institution's home loan originations and purchases, in dollars, that are located in low- to moderate-income (LMI) census tracts. This can be seen as one proxy for the CRA lending test. NCIF has proposed 40 percent for DLI-HMDA as an initial threshold for institutions to prequalify as CDBIs. The second core metric is Development Deposit Intensity (DDI), which is the percentage of physical branch locations that are located in LMI census tracts. Given that the presence of branches in these census tracts is likely to increase the availability of financial services; this can be one proxy for the CRA service test. NCIF has proposed 50 percent as the threshold for DDI.<sup>6</sup>

Using the scores on these two metrics, it is possible to map each domestic bank into a two-by-two matrix, as detailed in Figure 1. Although banks located in Quadrant 1 meet both

---

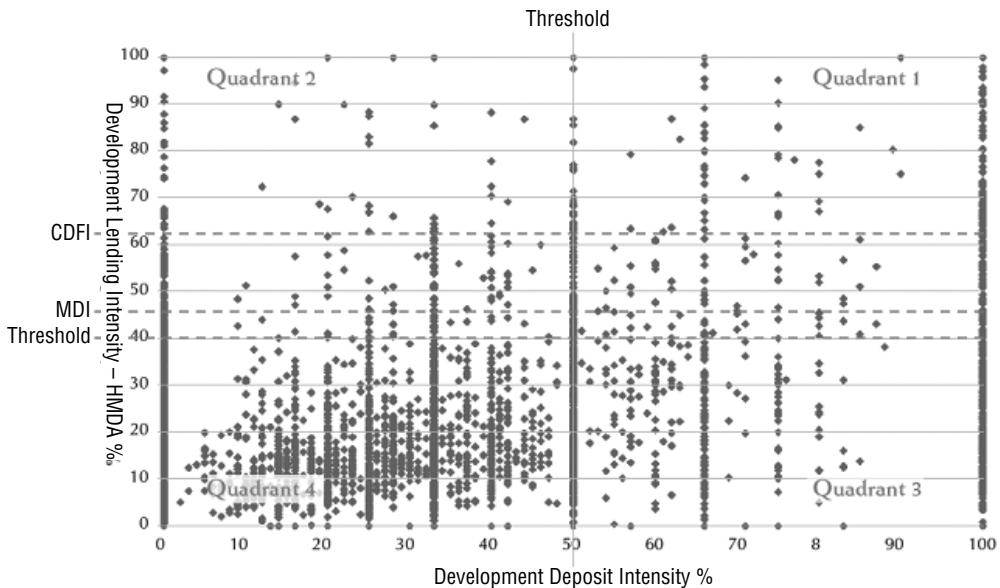
4 See David Porteous and Saurabh Narain, "Social Performance Measurement for CDFI Banks." In *Reengineering Community Development for the 21st Century*, ed. Donna Fabiani and Terry F. Buss (New York: M.E. Sharpe, 2008). The metrics are available at [www.ncif.org](http://www.ncif.org) (see "database tool" tab).

5 See Saurabh Narain and Joseph Schmidt "NCIF Social Performance Metrics: A Quantitative Approach to Measuring the Social Impact of Banks and Thrifts, and to Investing Capital in the Community Development Banking Sector" White paper (Chicago: NCIF, 2008), available at [www.ncif.org/images/uploads/NCIF\\_SPM.pdf](http://www.ncif.org/images/uploads/NCIF_SPM.pdf).

6 Ibid.

thresholds, banks within Quadrants 2 and 3 have different attributes and their community development orientation needs to be analyzed further.

*Figure 1. Development Lending Intensity and Development Deposit Intensity of HMDA Reporting Banks*



Quadrant 1 is composed of institutions that score above the threshold value for both DLI-HMDA and DDI. By virtue of their lending activity and branch location, these institutions display a high level of activity within low-income communities and that activity is likely a sign of a community development mission.

Quadrant 2 is composed of institutions that score above the DLI-HMDA threshold, but below the DDI threshold. These institutions are providing a high level of home mortgage lending within low-income communities, and that activity indicates a high degree of social performance. NCIF considers these institutions to be potential CDBIs and is interested in gathering more information about their operation.

Quadrant 3 is composed of institutions that score above the DDI threshold, but below the DLI-HMDA threshold. These institutions operate at least half of their branches within low- to moderate-income communities, and as a result are offering important financial and nonfinancial products and services within areas that are typically underserved by the mainstream banking community. Also, by being physically located in a community, the bank is providing a level of accountability to the community.

Quadrant 4 is composed of institutions that do not meet either threshold value. However, scoring below the threshold value does not necessarily indicate that these institutions are

not committed to community development. They may be active in other community development work that cannot be captured by these metrics. Investors should use other metrics for evaluating Quadrant 4 institutions, as appropriate.

By using the metrics, investors can readily identify institutions that are providing services to low-income and underserved communities. But do those services result in a positive outcome? Recent research would suggest so. Studies have demonstrated a link between the volume of financial intermediation and economic growth at a national level. Therefore, it is now generally accepted that increased levels of financial intermediation have a “first order positive causal impact on economic growth,” according to Ross Levine.<sup>7</sup> Put another way, increasing the amount of loans and deposit accounts in a given area increases the area’s overall economic growth.

### *Qualitatively: The NCIF Model CDBI Framework*

The NCIF Social Performance Metrics are powerful quantitative tools for measuring the community development impact of a bank’s lending. However, it is necessary to augment the metrics with a qualitative analysis that examines additional aspects of an institution’s operations. To determine if a bank is truly mission focused, it is essential to use the model CDBI framework (see Figure 2).

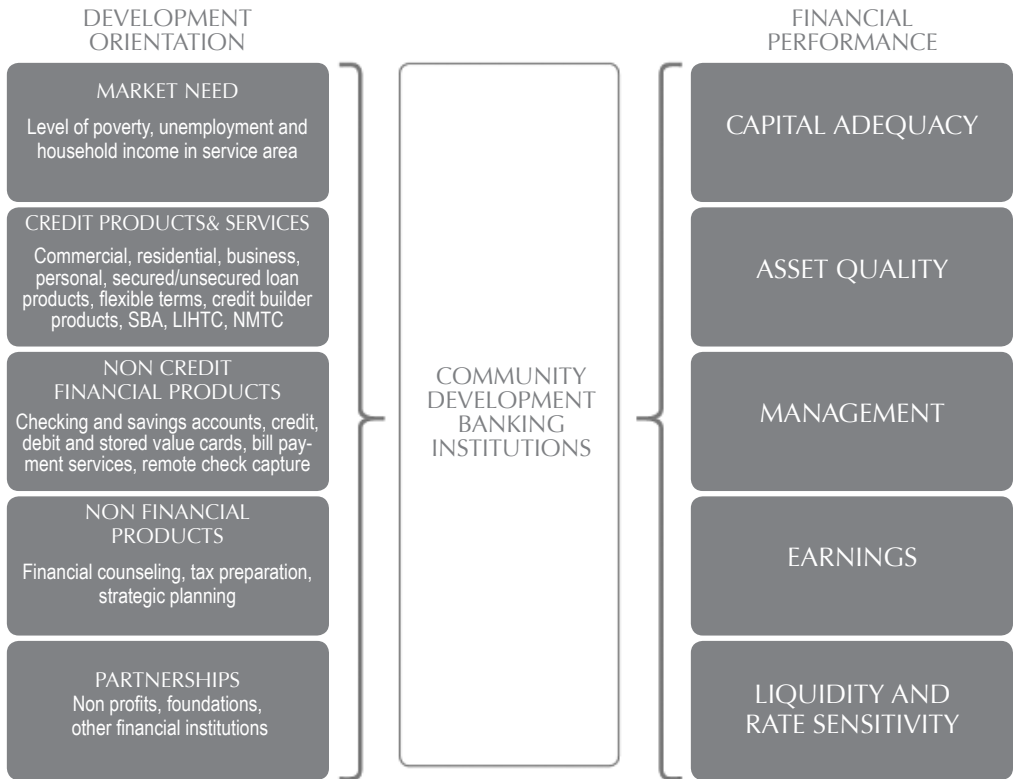
This framework deepens the quantitative analysis and helps investors gain a comprehensive understanding of whether the institution truly has a “double bottom-line” mission.

It poses questions about the community the bank serves and how the bank serves that community. For example, the model gathers information on the market needs of the community. Is the bank located in a community with a high poverty or unemployment rate? Is the bank serving an area with a low median family income? What are the various products and services the bank offers? Does the bank provide innovative products that are tailored to the needs of their community? Are they providing financial literacy and counseling to their customer base? Is the bank active in creating partnerships that will enhance the bank’s impact and improve the delivery of products and services? Is the bank working with local government, nonprofit organizations, and religious groups to maximize impact?

---

7 Levine, R (2005) “Finance & Growth: Theory and Evidence” in Handbook of Economic Growth, Elsevier.

Figure 2. Model CDBI Framework



**Investing in Community Development Banking Institutions**

*Identifying and Allocating Investment in CDBIs*

To help investors allocate assets on the basis of their programmatic and geographic objectives, NCIF developed an additional method and algorithm that can identify CDBIs serving as community development catalysts. The “investment allocation methodology” is a function of organizational information, financial performance criteria, and social performance criteria. By working with NCIF, investors receive assistance in creating a customized portfolio of investments in CDBIs that serves as a vehicle for investing into targeted communities. This portfolio can also be tailored to meet an investor’s impact, risk and return criteria. For example:

$$\text{Potential CDBIs} = f \{ \text{Organization Information, Geographic Location, Financial Risk and Performance, Social Performance Metrics, Model CDBI Framework} \}$$

- Organization Information includes data on whether the bank is a certified CDFI Bank, whether the bank is minority-owned, whether the bank is publicly or privately owned, etc.

- Geographic Location refers to the city and state of the bank’s headquarters and branch operations.
- Financial screens are based on a traditional financial analysis of a bank.
- Social Performance Metrics are based on the methodology defined above.

The database tool, located on the NCIF website, allows investors to customize a methodology to identify high-impact CDBIs. NCIF has collected information on financial and social metrics since 1996, and it can create customized investment allocation algorithms that meet investors’ criteria for a period in time or as a time series. Although there is much work to be done, NCIF’s “investment allocation methodology” has had some initial success. In the prior 12 months, NCIF’s work with interested investors has resulted in moving approximately \$70 million of new deposit funding into the CDBI sector.

### *Illustrations of the Investment Allocation at Work*

Investors have a variety of needs and goals when seeking to invest in communities. They may hope to increase affordable housing or improve access to banks, or they may hope to spur retail development and jobs. The NCIF’s quantitative and qualitative tools can help assess the viability of each of these goals. Investors have used the tools for a variety of goals. Below are three sample queries illustrating how investors are using the social performance metrics and website database tool to identify potential CDBIs .

#### **Example 1. Investment Allocation Based on Current Institutional Performance**

An SRI investor wants to make deposits in Illinois-based banks with \$100 million or more in assets and a distinct housing focus. The banks should also be innovators in retail financial services, with 50 percent of their branches in LMI areas and more than 60 percent of their home lending in LMI areas.

**Search Results:** Illinois-Service Federal Savings & Loan, ShoreBank, Pacific Global Bank, Second Federal Savings & Loan

#### **Example 2. Investment Allocation Based on Institutional Performance Over Time**

A foundation wants to provide program-related investments to CDBIs with assets between \$250 million and \$1 billion that have at least 80 percent of their housing loans in low-income areas, and have tripled the percentage of their housing lending in low-income areas since 2003.

**Search Results:** First National Bank of South Miami, BNB Bank, OMNIBANK, Fullerton Community Bank FSB, Republic Bank of Chicago

### Example 3. Investment Allocation Based on Performance Relative to a Peer Group

A CDFI bank in the Southeast wants to create a customized peer group of all southeastern CDFI banks and Minority Depository Institutions with assets between \$150 million and \$1 billion, Return on Average Assets greater than 25 basis points, more than 40 percent of branches in LMI areas, and a percentage of Home Mortgage Disclosure Act housing lending located in low-income communities. The goal is to then compare the social impact of the CDFI Bank relative to this peer group.

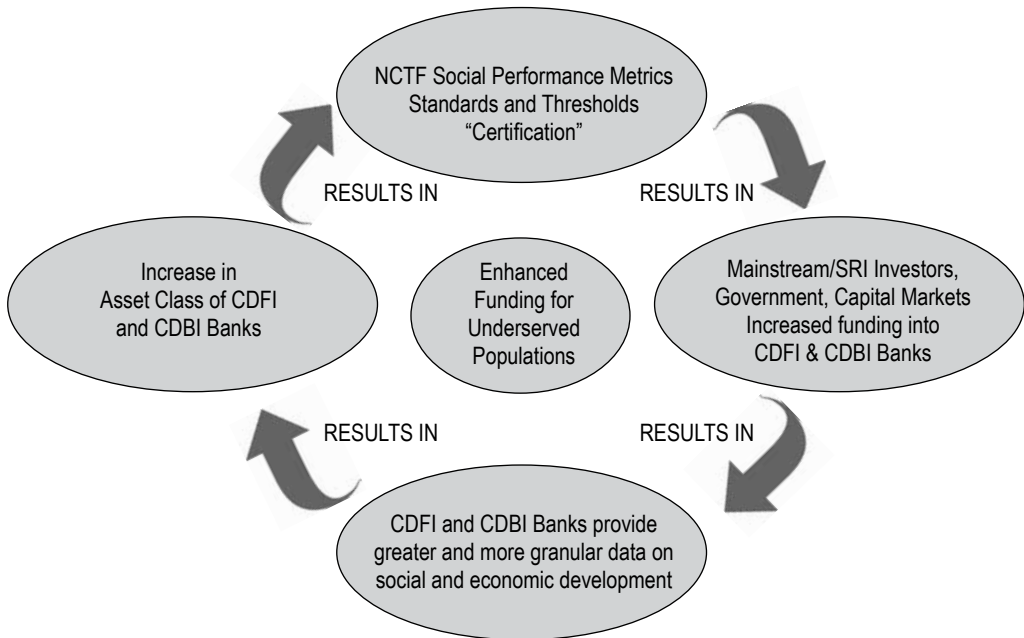
**Search Results:** Elk Horn Bank and Trust Company, Southern Bancorp Bank of Arkansas, City First Bank of D.C., Premier American Bank, Citizens Trust Bank, Capitol City Bank and Trust, Liberty Bank and Trust Company, Guaranty Bank and Trust Company, M & F Bank, Lumbee Guaranty Bank

### The Future of Impact Investing

As mentioned earlier, Socially Responsible Investing has historically focused largely on screening and shareholder advocacy with a relatively small proportion of investment going to community investing. As SRI investors increase the proportion of portfolio allocations to this sector, they are requesting detailed information on community impact. Unfortunately, while the CDBI sector has generated strong impact, the sector may not have succeeded in communicating this impact in a quantitative manner. With the Social Performance Metrics methodology, there is an opportunity for CDBIs to communicate this impact to investors and other stakeholders; in return the CDBIs hope to get tangible value out of the investors.

Currently, NCIF identifies high performing CDBIs through the publicly available data analyzed through the Social Performance Metrics methodology and through the Model CDBI Framework. However, as investors utilize these valuable tools to place deposits and other investment ‘products,’ the ‘vehicles’ delivering the impact will be required to provide additional data that both demonstrates impact and adds to the value of the Social Performance Metrics, thereby creating the virtuous cycle of high impact community investing (Figure 3). Several CDBIs are already demonstrating their willingness to report more impact information to investors since these institutions have received greater funding from the socially responsible investor community.

*Figure 3. Virtuous Cycle of High-Impact Community Investing*



NCIF believes that, eventually, many CDBIs will recognize the value of communicating their community development impact, thereby increasing the asset class of mission oriented financial institutions in the country. As CDBIs meet the reporting requirements of the SRI community by becoming more sophisticated in the collection of impact data, they are also likely to expect an increase in funding support. In the final analysis, this virtuous cycle will result in a substantial increase in the flow of capital to the ultimate beneficiary – the underserved in this country.

NCIF encourages and fully expects that the Impact Investing industry will seek many more social metrics on positive outcomes and will then reward the sector with increased dollars. NCIF also expects that, over a period of time, measures of social return will emerge that will be additive to the financial return achieved from these investments.

## Conclusion

Community Development Banking Institutions serve as a strong intermediary for socially responsible investing because they know their communities and can quickly and efficiently get investment dollars to where they are most needed. However, identifying CDBIs used to be difficult because there were no transparent measure to indicate a bank’s level of activity in LMI areas. Also, many banks are not certified as CDFIs but yet have a mission of community development.

To fill this gap, NCIF developed a tool—the NCIF Social Performance Metrics—to identify banks with a community development mission. The tool helps to identify institutions whose activity is largely focused in low-income areas and whose positive effect on community development is notable. The Development Lending Intensity metric assesses the share of an institution’s home loan originations and purchases that are located in lower-income areas, while the Development Deposit Intensity measures the share of a bank’s branches that are located in these communities. Institutions performing highly on these metrics are identified with the dual objectives of recognizing the impact they have on their communities and increasing the level of funding that is available to them.

Currently, NCIF is working closely with the SRI community to direct new investment funding to the CDBI sector. During the past year, this work has resulted in moving approximately \$70 million of new deposit funding into the CDBI sector. NCIF hopes to build on this initial success and to work with both the SRI and CDBI industries to develop a virtuous cycle of high-impact community investing that will result in a substantial increase in the amount of new community investing that is directed to CDBIs throughout the country.

*Saurabh Narain is chief fund advisor (snarain@ncif.org) and Joseph Schmidt is fund advisor (jschmidt@ncif.org) at National Community Investment Fund (www.ncif.org). NCIF is a nonprofit private equity trust set up to invest capital in Community Development Banking Institutions in the United States. NCIF created the social performance metrics.*



## Reject the Reset!

*Jed Emerson*

*The present crisis in global capital markets rolls on.*

And although it will be months—if not years—before we have a definitive analysis of the many practices that came together to drive recent events, a number of contributing factors are clear to many, including:

- a subprime mortgage market in which lenders provided credit to those without the means to support it, which culminated in a massive asset bubble,
- a misalignment of incentives that runs between those packaging investments, those buying them, and the firms that made use of the capital such investments provided,
- a decoupling of risk and reward through the extensive, misappropriate use of derivatives, which led to investors trading paper unconnected to the supposed value of the underlying assets,
- the subsequent warehousing of eroding assets in banks around the world, which has led to an asset-liability mismatch of gross proportions,
- a weakened regulatory environment that was allowed to evolve in the face of strong growth and political hubris.

Take your pick from the above list or a favorite list of your own, but the truth is, numerous factors played a significant role in a resulting capital blackout of massive proportions, the effects of which will be felt for many quarters to come.

As both the public and private sectors cobble together a hoped-for solution to this ongoing crisis, one word is consistently bandied about: reset. Many have suggested that we should reset the financial system clock to an earlier time when there was less leverage; to a time when we all thought we knew the value of a deal and the terms of investing. The notion of a reset suggests capital markets and their various actors on both the buy and sell side should be allotted a comprehensive “do over” to allow us all to return to this ethereal “time before.”

Such a call to reset would have us believe that, in truth, the core premises that led to our excess are somehow sound, that we simply got a little carried away in both our free-market rhetoric and artificially inflating charts of account. Calls to reset would have us believe this is simply a particularly bad part of the cycle and all that is required to overcome the current crisis is a chance to try, try again; perhaps with slightly lowered expectations and bank accounts, but playing the old game on a newly cleared table with a fresh deck of cards.

The problem with the concept of a reset is that it is not a revision, revisiting or reconsideration, but rather a return to prior practices and understanding of value. It speaks to dialing back certain corporate and investing practices, but it does not seek realignment of

incentives or to redefine the value proposition in a manner that speaks to the long-term interests of capital and communities. In truth, what is needed is not business as usual, but rather business anew, a reconsideration of how we think of not only finance and investing but capital systems and global economics. What is called for is a fundamental reframing of how we understand the nature of finance and capital markets.

As the mud clears and financial waters run anew, what is revealed is that rather than simply returning to the practices of the past, we have the opportunity to redefine how we understand investment options, types of return, and the notion of risk.

For example, during one recent conversation with a significant institutional investor, there was a moment when the conversation approached the surreal.

On the one side was the endowment's investment officer, charged with pursuing commercial returns, discussing how direct investments were down more than 30% and that the portfolio as a whole had taken an equivalent nose-dive.

Across the table sat the "social" investment officer, charged with managing investments for which financial return was not the only measure of performance, but where social and environmental factors were also taken into account. These constituted investments in community development finance institutions (CDFIs), as well as other "sustainable" investments; on the whole, investments their board considered "high risk, low return" allocations, but ones they believed important given the organization's overall mission. The social investment officer discussed how that portfolio's investments were up more than 5% during the same reporting period.

And in the middle sat their boss, trying to figure out how the mainstream markets had done so much damage while the "new alternative" products had performed so well.

The World Bank's International Finance Corporation defines sustainable finance along the following lines:

*Sustainable Finance integrates financial, social, and environmental considerations into decision making, facilitating improved risk management and higher return on investment. Financial institutions can potentially be affected by social and environmental issues through the operations of their clients. Social and environmental issues within a financial institution's portfolio may translate into business risks for the financial institution. There are three types of risk a financial institution could be exposed to arising from the social and environmental issues of their clients: credit risk, liability risk and reputational risk.<sup>1</sup>*

It is more than a little ironic that had the mainstream investment community been managing their portfolios along the lines of a more sustainable approach to capital investment, the current crisis might have been diluted—if not avoided in its entirety. Yet when it came to the subprime mortgage market, lenders were not focused on knowing the true risk or

---

<sup>1</sup> <http://www.ifc.org/ifcext/sustainability.nsf/Content/SustainableFinance>.

debt-carrying capacity of underlying borrowers—and transparently communicating that risk to potential investors. Rather, mortgage lenders succumbed to the promise of easy fees and “cheap” credit, which laid the seeds of the current crisis, leaving banks around the world to deal with what is politely referred to as “asset erosion.”

Subsequent to the meltdown, some community development finance groups certainly find their borrowers and assets thrown into the common tumult of the current recession. However, prior to getting swept up in the waves of this recession, those investments were quite sound and performing well. These investments were (and most still are) of a steady and deliberate form, with lower financial returns but also carrying lower risk exposure than other commercial products in the investment basket. The risk carried by microfinance bond offerings, community notes, and other instruments has been lower because the focus of those structuring such deals was not on fee and profit generation, but on deeply understanding the market of inner-city lending and business development.

It would seem a central challenge and responsibility of traditional finance (to accurately assess, gauge, and price the risk and true value of traded products) was left to grapple with the significant shortcomings of its system. Meanwhile, a more cautious and, dare we say, sustainable approach to asset management and investing would have at least held out the possibility of managing risk in a more effective way that met a higher standard of fiduciary responsibility. This higher standard is one that acknowledges that responsibility is not simply to the pursuit of financial performance, but rather total returns. The responsibility is to also view these returns not simply as a function of numeric performance, but also with consideration of off-balance sheet risk, represented by a host of social and even environmental factors not traditionally considered in the calculus of mainstream finance.

If we are to not just regroup prior to taking another plunge off the next capital cliff, we must reframe our understanding of markets, capital, and finance toward a more holistic definition of value, risk, and return. We must seek to use new and proven tools of community finance and development, which offer financial performance with social and environmental value creation. And we must execute investment strategies that break down the wall between investments that are supposed to do well and those thought to do good. At its core, value is itself whole, a blend of various levels of financial performance and return with consideration of social and environmental risks. And the investment tools we may draw on come from a box much larger than we have traditionally thought.

Rather than a return to the practices of the past, we must reframe our understanding of the value we seek to create and the best strategies for doing so. We must reject the reset and engage in a collective reframing of how we invest, trade, and pursue the blended value generated from the diverse actors within our global, national, and local markets.

*Jed Emerson is managing director for Integrated Performance with Uburu Capital Management. He has held faculty appointments at Harvard and Stanford Business Schools, and is a visiting fellow with the Saïd School of Business, Oxford University.*

## Rethink Charity

*Dan Pallotta*

*Author, "Uncharitable"*

Charity has come to business. From the holistic approach of Whole Foods to Product RED's directing corporate advertising dollars to Target's massive charitable giving program, business is realizing that making a difference in the world makes a difference for a brand. They are realizing that Milton Friedman's insistence that social causes had no place in business overlooks the competitive advantage created when companies align with a cause.

Yet the sad reality is, with a few minor exceptions, business has not yet come to charity. It is not the fault of charity. For well over a decade, it has been popular to preach to charities that they should act more like business. But the truth is, society does not permit it. This reality is not likely to cease without revisiting some fundamental canons in charity. What we mean by "act more like business" is really, "focus more on lowering overhead," the opposite of what it takes to build a successful business.

The nonprofit sector remains tightly constrained by a set of irrational economic rules that discourage profit, self-interest, serious marketing, risk-taking, and long-term investment in developing revenue. These rules work against the sector on every level, and they have been elevated, of all things, to the status of "ethics."

The word "profit" comes from the Latin noun *profectus*, meaning "to progress." So the term "nonprofit" means literally, non-progress. The sector remains bound by its Puritan roots. Although the Puritans were aggressive capitalists, they were also Calvinists. Calvin taught that self-interest was a sure path to eternal damnation. Big problem for a capitalist. Calvinists constructed charity to mitigate the reality of their self interest: On this side of the line we can make a profit, and on the other, which we shall call "charity," we will deny ourselves. Therefore, how could anyone make money in charity if charity was one's penance for making money? The merchants got free-market capitalism, and the needy got a religion, charity, which banished everything that worked in commerce. By and large, it is still what the needy have today.

In essence, we have two rulebooks: one for charity and one for the rest of the economic world. We let the for-profit sector pay competitive wages based on value, but have a visceral reaction to anyone making a great deal of money in charity. We let people make a fortune doing any number of things that will harm the poor, but want to crucify anyone who wants to make money helping them. The illogic of it is breathtaking. This sends the top talent from the nation's best business schools directly into the for-profit sector and gives our youth mutually exclusive choices between doing well and doing good. It is not sustainable, let alone scalable.

We let Coca-Cola pummel us with advertising, but donors do not want important causes "wasting" money on paid advertising. Therefore, the voices of our great causes are muted. Consumer products get lopsided access to our attention, 24 hours a day. Charitable giving has remained constant at about 2 percent of GDP since we first began to measure it. Charity is not gaining market share. How can it if it is not permitted to market?

We let for-profit companies invest in the long-term to identify new sources of revenue,

but we want our charitable donations spent immediately to help the needy. All results must be measured against expenditures in 12-month windows, and a 65 percent return is required. No wonder charities cannot scale to the size of the social problems they confront.

We are not upset when Paramount makes a \$200 million movie that flops, but if a charity experiments with a \$5 million fundraising event that fails, we call the attorney. The result? Charities are petrified to try bold new revenue-generating endeavors and cannot develop the powerful learning curves the for-profit sector can.

We let for-profit companies raise massive capital in the stock market by offering investment returns, but we forbid charities to pay a financial return (“profit”). The result? The for-profit sector monopolizes the capital markets while charities are left to beg for donations.

Policing these situations is a deadly question that grossly oversimplifies reality: What percentage of my donation goes to the cause? Experts agree it is the worst possible question we could be asking. Why?

- 1) It tells you nothing about how the charity is spending the money that goes to the cause. A soup kitchen can tell you 90 percent of your money goes to the cause and you’ll never know they’re serving rancid soup.
- 2) Charities game the system. They broaden their internal definition of “the cause” to give you any number you want to hear (they then use that number to tell the public they are more “efficient” than another charity that is actually doing better work, but that uses far more conservative accounting.
- 3) It creates a fictional demon called overhead, which characterizes as negative anything and everything designed to build the organizational strength to solve problems.

We’re rethinking business. So why not rethink charity? It is time to give charity the big-league freedoms we give to business: the freedom to get the best people and pay them whatever it costs for the value they can produce; the freedom to buy ads on the Super Bowl, even at a cost of \$2.6 million a pop, to start building market demand; the freedom to take big risks to earn big revenue, to fail big if that’s what it takes to learn; and the freedom to start attracting capital in a stock market by paying investors a financial return. The fight for these freedoms must be our new cause because without these freedoms, all of our causes are lost.

*Dan Pallotta is the founder of Pallotta TeamWorks, which created the multi-day, four-figure pledge minimum charitable fundraising event category. The company invented the AIDS Rides, the AIDS Vaccine Rides, the African AIDS Trek, the original Breast Cancer 3-Day walks, and the original Out of the Darkness suicide prevention overnight event. These events grossed \$556 million in donor contributions and netted \$305 million for charity after all expenses in nine years – more money, raised more quickly for these causes than any known private event operation in history. The company also drew its share of vocal critics who took issue with the for-profit company’s marriage of compassion and capitalism at a time before notions like “venture philanthropy” and “creative capitalism” were in vogue. Dan graduated from Harvard University in 1983 and lives in Los Angeles with his partner and their three children.*

# Local Stock Exchanges and National Stimulus

*Michael Shuman*

*Business Alliance for Local Living Economies*

Since the global financial system unraveled in 2008, U.S. policymakers have struggled heroically to improve the performance and oversight of global banks and investment firms. But these actions have been largely unresponsive to the growing number of Americans who would like to remove their hard-earned retirement savings from these high financial fliers altogether and invest their nest eggs instead in their community. Might it be time for policymakers to consider the potential stimulus payoffs from nurturing micro-equity investments?

One reason for growing public interest in local investment is the spread of “buy local” campaigns, a movement that is more than just local hucksterism. Consider the title of an article in a recent issue of *Time*: “Buying Local: How It Boosts the Economy.” Cutting-edge economic developers (except at the national level) increasingly recognize the importance of strengthening locally owned, small businesses.

Growing evidence suggests that every dollar spent at a locally owned business generates two to four times more economic benefit—measured in income, wealth, jobs, and tax revenue—than a dollar spent at a globally owned business. That is because locally owned businesses spend much more of their money locally and thereby pump up the so-called economic multiplier. Other studies suggest that local businesses are critical to tourism, walkable communities, entrepreneurship, social equality, civil society, charitable giving, revitalized downtowns, and even political participation.

Despite this overwhelming body of evidence, the national stimulus efforts have proceeded with no specific attention to local businesses. Yet even some very simple reforms that opened up local businesses to local investors could make a huge difference.

Consider two anomalies of the current financial system (even if the latest reforms work exactly as planned). The first is that locally owned, small businesses constitute about one-half of the private economy in terms of output and jobs, but they receive almost no investment from the nation’s pension funds or from mutual, hedge, venture, or any other kind of investment funds. In a well-functioning financial system, roughly one-half of the investment should go to roughly one-half of the economy. Today, every American, even the stalwart advocate of community development, is overinvesting in the Fortune 500 companies and underinvesting in local businesses key to local vitality. This is a colossal market failure.

Does this occur because local businesses are less profitable than global ones? Hardly. According to the Statistical Abstract, sole proprietorships (the legal structure chosen by most

first-stage small businesses) are nearly three times more profitable than C-corporations (the structure of choice for global businesses).

Moreover, several global economic trends are now making U.S. local businesses increasingly competitive. Rising energy prices make local production for local consumption more competitive against Wal-Mart production in China. The falling dollar revitalizes U.S. manufacturers. As Americans shift their spending from goods to services, a trend that has been occurring for 50 years, local businesses will see more competitive opportunities still, given that most services depend on direct, personal, and ultimately local relationships.

A more plausible explanation for the absence of local business investment is the paucity of market-clearing mechanisms, essentially local stock exchanges, that would allow local investors to find, buy, and sell local securities. Interestingly, smaller stock exchanges, primarily facilitating intrastate transactions, were quite common until the securities reform acts of the New Deal era. Some were poorly designed and fraught with fraud and inefficiency, but others were reasonably successful. Once the national exchanges became reliable and widespread, however, businesses and traders alike gravitated away from the state exchanges. Today, only a half dozen public exchanges still operate in the United States.

Given the fact that market-clearing mechanisms exists on a limited scale, one must ask why local businesses do not use them. Without sacrificing their local character, for example, local businesses could issue nonvoting preferred shares of stock for national investors and trade them over the counter on existing exchanges. There is certainly no technical reason this could not be done. Prosper.com and Kiva.org have demonstrated how small businesses seeking microloans can be vetted, listed, and exchanged efficiently.

The real reason small public offerings and local stock exchanges do not flourish today is that the Securities and Exchange Commission (SEC) has essentially banned them. Existing laws place huge restrictions on the investment choices of small, “unaccredited” investors—a category in SEC vernacular that includes all but the richest two percent of Americans. The regulations prohibit the average American from investing in any small business, unless the firm is willing to spend \$50,000 to \$100,000 on lawyers to prepare a private placement memorandum or public offering—thick documents with microscopic, ALL CAPS PRINT that no human being has ever been observed actually reading.

Which brings us to the second anomaly of today’s financial system. Suppose you wished to play blackjack in one of the more than one thousand casinos operating across the United States. Do you first have to prove that you’re an accredited gambler? Must you read a thick disclosure statement letting you know the risks of blackjack before you place your first bet? Everyone understands that these would be silly requirements.

We have two fundamentally contradictory legal regimes operating today. One, called gambling, allows every adult, irrespective of income, to risk everything for a probable loss. Another, called small-stock investing, prohibits 98 percent of us from investing in the local businesses that are essential for the well-being of community, unless businesses pay prohibitively expensive lawyers’ fees to prepare the unreadable disclosure statements.

Something is deeply wrong here. Outdated federal securities laws have left Main Street

dangerously dependent on Wall Street, and overhauling them may well be a key to economic revitalization.

The good news is the local businesses could get a huge investment boost with some modest securities reforms that would cost little or nothing. One easy reform would be for the SEC to exempt from its usual expensive disclosure requirements any low-risk public ownership of locally owned microbusinesses. By low-risk, I mean that no person can hold more than \$100 worth of any one stock—which means that we’re freeing up people to engage in the risk equivalent of a nice dinner for two. By local ownership, I mean that only residents within a state can buy, hold, and sell stock shares. And by microbusinesses, I mean any business with a total stock valuation on issuance of less than \$250,000.

A related reform would be for the SEC to set simple rules for the setting up of internet platforms for trading the exempt securities above. The few remaining national players, such as the New York Stock Exchange and the NASDAQ, have enough authority now to launch a product that would enable states, regions, or municipalities to set up trading portals. But because they do not see large profit opportunities—a mistaken judgment, in my view—it will probably fall to new entrepreneurs, such as Mission Markets, to redesign local exchanges for smaller, slower transactions. The SEC should streamline its regulations to enable more such exchanges to get off the ground at an affordable regulatory price.

*Here are a few other legal reforms that would be helpful:*

- Micro-investment funds. Let’s allow small investors to pool their money in backyard investment funds (again, up to \$100 per person) that in turn invest in diverse portfolios of local stocks. (Only the super rich can invest in such funds now.)
- Co-op investment funds. Let’s allow cooperatives, most of which are owned by workers or consumers living in a single community, to set up investment funds empowered to make local investments on behalf of their members. (Currently, they can only invest members’ capital in businesses owned and run by the co-op itself.)
- Pension fund participation. Let’s allow any pension fund that places as much as 5 percent in local securities, either directly or through microbusiness investment funds, to meet legal standards of “fiduciary responsibility.” (Current regulations define the term in a way that directs virtually all such investments must go to global companies.)

New community-based funds, securities, and exchanges, of course, still need oversight to prevent fraud and ensure accountability. However, given that nearly all local investment is, by definition, intrastate, these new rules could be left to the existing securities departments in the 50 states. Once state-level laws are put into practice, many of the absurd requirements of the SEC expensive audits and lengthy legal filings might finally disappear.



Were these reforms enacted nationally, literally trillions of investment dollars could begin to move into the local business economy. Entrepreneurs, hungry for new capital in the post-meltdown credit crunch, would begin to restructure their businesses to receive microcapital. Investors terrified about betting all their money in the global firms with a checkered past would start shifting their investments to local businesses they know, trust, and can visit and “ground-truth” with tough questions. The result will be a nation of stronger local economies, with American investors increasingly placing more of their money into backyard businesses.

Two final points about these ideas. First, the experimentation opened up at the state level will invite other grassroots engagement, invention, and competition that will help demonstrate the viability of simpler, cheaper, more transparent investment regulatory frameworks. Second, and most significantly, all these regulatory reforms will cost almost nothing. Instead of spending billions more in federal taxpayer dollars to prop up dubious big financial institutions, why not create for free a system that is more stable, safe, lucrative, and democratic?

*Michael H. Shuman is director of research and public policy for the Business Alliance for Local Living Economies (BALLE), and author of *The Small-Mart Revolution: How Local Businesses Are Beating the Global Competition* (Berrett-Koehler, 2007). He blogs regularly at [www.small-mart.org](http://www.small-mart.org).*

## At the Crossroads Where Economic Development, Job Creation and Workforce Development Intersect

*“All truths are easy to understand once they are discovered; the point is to discover them.”*

— Galileo

***Carla I. Javits***

*REDF*

Like a pattern forming in a kaleidoscope, the twin issues of job creation and employee training are emerging as a major focus among groups as diverse as the U.S. Chamber of Commerce and the AFL-CIO, environmentalists and proponents of infrastructure growth. In the face of extraordinary challenges, business, labor, environmentalists, and government are seeking ways to reinvent and revitalize our economy with breakthrough innovations such as “green jobs,” and private-public partnerships to build infrastructure. “Business as usual” is clearly not the road to success.

With job creation at center stage, and unemployment at record levels, how to stimulate economic growth while creating decent jobs that pay a living wage, and preparing a workforce capable of working in new ways and in new industries, has gained more interest than has been the case in many years.

This is both the best and the worst of times to spotlight a solution to the disproportionately high unemployment rates that have persisted for our most vulnerable citizens since long before the current economic downturn. This includes at-risk youth and adults who have experienced homelessness, incarceration, or have not graduated high school. This is the worst of times because of the overwhelming needs of the millions of people recently laid off and now unemployed. But it is the best of times because more of us are now acutely aware of the financial and human costs of unemployment, and more willing than in the past to try new things to solve the problems at hand.

A powerful, cost-effective solution to chronic unemployment—well-suited for the times—is an innovation that blends job creation, economic and workforce development, and training. “Social enterprises” are businesses created for the explicit purpose of hiring hard to employ workers, including at-risk youth and those affected by homelessness and incarceration. Run by nonprofit organizations, these enterprises are cost-effective because they cover a significant portion of their costs through earned income.

They represent a breakthrough in the financing of transitional job creation, a proven model for delivering on-the-job training to help people with high barriers move into the workforce.

## Why This Population and This Solution?

Why is it worthwhile to focus attention on this population and this solution, even in the context of massive unemployment? First, social enterprises result in positive financial and social benefits, saving taxpayers with reduced incarceration and homelessness, while contributing to economic growth through job creation and the delivery of needed goods and services. Employment in social enterprises generates hope, social networks, income, and family reunification for those who get the jobs. It also teaches the work attitudes and basic skills necessary for frontline jobs, while preparing people to participate in education, training, and apprenticeship programs that can help them advance in the future.

This approach to employing those with high barriers delivers against a triple bottom line:

- (1) The positive social and tax benefits that work provides;
- (2) A fast, direct route to economic stimulus; these workers are particularly likely to spend wages quickly on local goods and services; and
- (3) The additional tax savings resulting from reduced use of institutionalization and safety net services, even more critical now as the state, counties, and cities struggle to balance budgets.

## Examples of Social Enterprises

Entrepreneurial nonprofit organizations operate these employment-based enterprises. The enterprises earn revenue by delivering goods and services such as landscaping, screen printing, recycling, maintenance, food services, and property management. While the income earned by the social enterprises covers most of the normal business costs, private philanthropic and public funding for education and other social supports complement the income. The education and social supports in turn help employees succeed, and advance into private-sector jobs.

The jobs they create are deliberately intended as a first step into the workforce. The enterprises combine real employment opportunities with an ethos and management practice that foster the success of people who want to work but who are unlikely to be given the opportunity or the necessary support by traditional employers.

Enterprises in the San Francisco Bay Area include Rubicon Programs, Community Housing Partnership, San Francisco Clean City Coalition, the San Francisco Conservation Corps, New Door Ventures, Juma Ventures, Goodwill, St. Vincent de Paul of Alameda County, and Community Gatepath. These groups, along with others such as Homeboy Industries in Los Angeles and Pioneer Human Services in Seattle, have already helped thousands of the most vulnerable individuals move into the workforce.

## The Impact of Social Enterprise

Individuals who go to work in these employment enterprises learn life and work skills on the job, connect to education and certification as needed, and successfully move into and retain private-sector employment. The enterprises are able to build relationships and pathways to help employees move into traditional private- and public-sector jobs, preparing entry-level workers for careers in companies and agencies that offer the potential for advancement.

## The Evidence

REDF, a San Francisco-based nonprofit providing philanthropic “venture capital” and business assistance to social enterprises, has worked with high-performing groups that have provided a first step into the workforce for more than 3,700 people. These enterprises have helped employees successfully transition into other jobs. Approximately three-fourths of those interviewed two years after hire were still employed, including those working while enrolled in an academic or vocational program. An additional 12 percent were enrolled in academic or vocational programs and not working.<sup>1</sup> A recent study of New York City’s Center for Employment Opportunities, which employs parolees in a social enterprise/transitional jobs model, shows reductions of 10 percent in reincarceration, resulting in millions of dollars saved.

## Scaling Up This Approach

As with any business, social enterprises can create more jobs when they sell more goods and services. To do so, the public and private sectors—businesses and government agencies—must purchase more of their landscaping, screen printing, recycling, and other goods and services. The enterprises also need complementary, cost-effective, public- and private-sector contributions for the supports that help employees succeed and move into private-sector jobs. As government investments in infrastructure and green jobs ramp up, the public agencies and private contractors who receive the funds should consider how to contract with social enterprises to achieve a triple bottom line: job creation, local economic stimulus, and taxpayer savings. Businesses, unions, and public agencies should look to social enterprises for a prepared, frontline workforce that they will need to hit the ground running as the economy recovers and new opportunities for growth emerge.

*As president of REDF, Carla sets REDF’s strategy in partnership with the Board of Directors and oversees its operations. Under her leadership, REDF has helped to create and grow San Francisco Bay Area employment-focused “social enterprises” – nonprofits that earn income while creating jobs for people with high barriers to employment. The enterprises REDF assists have moved more than 3,700 people into the workforce.*

---

<sup>1</sup> BTW Consultants, “Social Impact Report 2005” (San Francisco: REDF, 2005).

# Value

*Penelope Douglas*

*Pacific Community Ventures (PCV)*

**D**ictionary.com defines “value” as “the worth of something in terms of the amount of other things for which it can be exchanged.” Value is a concept that everyone understands, although what is valued, and how much worth something is given, varies from epoch to epoch, society to society, and from person to person.

In the Middle Ages, high value was placed on the ownership of an animal. During the creation of an independent United States, freedom of religious expression and from onerous rule was so highly valued that our forefathers risked everything for a stake in something so valuable.

The wild economic ride of the last decade could be said to have been fueled by another, seemingly benign value, the value placed on home ownership here in the U.S.

The San Francisco Chronicle recently noted that a barter economy is thriving these days in the Bay Area. This phenomenon provides a great insight; members of a community–focused society can and will find ways to return to beneficial, direct, and shared means to maximize assets of value. But one person’s, or one community’s, most highly valued asset, may not be the same as another’s. In the barter economy, the common focus (efficient use of what I already have), as well as the individual “stamp” on value, are harmoniously balanced. These themes of alignment along with individual decision are central to ideals for a society with more than financial value goals.

## **Valuing More Than Simply Financial Worth**

I like to think that a letter I sent to President Obama last winter really does sit somewhere in a clutter on his desk. In my letter, I (like countless others I am sure) made the case that he, and we, all take advantage of the massive economic mess we find ourselves in. I suggested we actually could have some tailwind, an easier ride on the path to a truly sustainable society. The sustainable society’s challenge: how to create a collective and compelling structure which places enduring value not just in financial assets, but in all assets, including clean air, abundant clean water, and good jobs where wealth is shared by all our citizens.

The ideals of the sustainable society are taking greater hold, especially in the realm of socially responsible investment. Between 2005 and 2007, socially responsible investment assets under management in the United States grew by 18 percent, compared to the broader universe of professionally managed assets that grew by just 3 percent. Today, one out of every nine dollars under professional management in the United States is involved in socially responsible investing. Investors want to not only avoid causing harm in their investments, but also to do good. The major shift is to a community-up activist orientation. People want

to do something which maximizes valuable outcomes—outcomes whose value is measured in many more ways than financial value. Communities want to own their original investment, and track its progress, whether that investment is their intellectual capital, financial capital, or personal labor. Activists want to invest not only for financial rewards but also to increase other non financial assets like farm fresh food, clean water, clean air, and high quality jobs.

*Here are some examples of how communities are making this happen:*

- This spring in Washington, DC, one of my board members, Sunil Paul, announced The Gigaton Throwdown Initiative ([www.gigatonthrowdown.org](http://www.gigatonthrowdown.org)). This call to action to massively scale clean energy is a wonderfully branded example of valuing more than simply financial returns.
- The California Fisheries Fund ([www.californiafisheriesfund.org](http://www.californiafisheriesfund.org)), working with the Environmental Defense Fund, is making small loans to fishery operations in California which are utilizing cutting edge innovations to operate fisheries which are both financially rewarding and which sustain not only fish populations and fishing grounds, but also individual fishermen using a community approach.
- We at Pacific Community Ventures have for ten years valued highly the intellectual capital of our network of volunteer Business Advisors, whose time as strategic advisors to small business owners has generated both quantitative and intrinsic value for both advisors and advisees.
- CalPERS and the Northwest Area Foundation, two distinctly different types of entities, have each demonstrated leadership in a community focused, activist approach towards their investment portfolios, and engage in disciplined evaluation of both financial and nonfinancial returns on investments.

## **Shifting the Power**

Financial wealth clearly creates power in our society; this is a fact of our modern world.

Each time we read of new milestones in philanthropic innovation or community based innovation, we simultaneously read articles like the one in the *New York Times* on July 20, headlined “cashing in again, on risky mortgages”, a story of a firm making its new money on questionable mortgage modifications after making a fortune delivering subprime mortgages in the last go-round.

How then do we shift some of the power structure to one aligned not just with money but also with other highly valued assets and outcomes?

I would suggest four innovations which, in combination, could create a meaningful, powerful, sustainable society investment structure.

### *Innovation One*

**A National Open Network for Alignment of Value at the Institutional Level.** We need to establish a network which provides communities of investors, as well as investment managers, a formal place to state investment proposals, and values sought. To fully enable value providers and value acquirers to negotiate a deal, we need an open network application that facilitates transparent dialogs between investors and managers about alignment of value sought. Such an online network will complement the much-needed work of building the impact investing industry infrastructure that the Global Impact Investing Network (GIIN), led by the Rockefeller Foundation, has undertaken.

Those seeking investment capital would be required to post and describe the value they intend to create for their investors. “Value goals” would be unique to each firm. These would however be required to be concrete and measurable. In all cases, the value goals would include all values to be created, and how each would be measured (including financial value). Examples of values might be:

- Petroleum use year over year
- Poverty reduction rates year over year
- Average wages and incomes for low-moderate income workers year over year
- Food grown and consumed locally year over year
- Fish populations year over year
- Health-oriented behavior changes year over year
- Financial return on investment

Those with capital to invest could then evaluate capital seekers’ value goals and plans to achieve them, and commit their capital according to what they value. Capital would flow to the projects that the community values.

### *Innovation Two*

**Portfolio Management Platform.** We must create an open platform to allow investors (individual and institutional) to view the available spectrum of value goals investment opportunities, across a spectrum of available choices. Purely non-financial value investments would be arrayed along with investments that blend both financial and social return. Tools would be available to allow the value goal investor to create a portfolio approach to investment.

### *Innovation Three*

**Local Open Network.** We must also create and replicate inclusive, local mechanisms for investment, ownership, and wealth building, based on a value goals set of principles. Local mechanisms such as local stock exchanges, community-based investment strategies such as Community Supported Agriculture, and health care access products, need to be replicated using a community-up approach.

Locally-based vehicles are critical because they allow individual community members to participate in new and powerful structures based on value goals, without barriers. They are an essential means to close income and equity gaps in our society. A national network of locally-based vehicles would enable and empower the community-up alignment of value goals as well as the efficient replication of local mechanisms in multiple communities.

#### *Innovation Four*

**A Movement Brand Identity.** We must establish a compelling brand identity in order for the business of value investment to compel and attract not only the early-adopters (those of us in the community development finance and impact investment niche) but also the majority of the potential marketplace. Of all four innovations, this may be the most important of all.

### **Conclusion**

Our society has always privileged the concept of value. What we need is an alignment between what a community values and how it allocates its resources. The four innovations I have proposed here: (1) a national, open network application, (2) a portfolio management platform, (3) local mechanisms for investment, and (4) a movement brand identity, will go a long way to enabling that alignment. The national network will facilitate deal-making between value-creating projects and investors. The platform will enable investors to look not just at individual investments, but at all elements of value created in their entire portfolio. Local mechanisms for investment will enable every community member—not just institutions—to fully participate. And, finally, brand identity will generate the critical mass and scale that will ultimately create a society that places value on the assets it cherishes for sustainability.

*Penelope Douglas is the President and co-founder of Pacific Community Ventures (PCV), a 10 year old nonprofit and investment organization based in and focused on California's underserved communities. Penelope previously worked in senior management at several companies including Wells Fargo Bank and Odwalla. She has chaired numerous boards of community based organizations including Juma Ventures and Larkin Street Youth Center, chairs the board of New Mexico Community Capital, and sits on the boards of small, socially responsible companies including Evergreen Lodge, New Leaf Paper and Adina for Life.*



## Could “Small Is Beautiful” Replace “Too Big to Fail?”

*Don Shaffer*

*RSF Social Finance*

I encourage you to read “The Quiet Coup,” by Simon Johnson in the May 2009 issue of *The Atlantic*.<sup>1</sup> Johnson is a former chief economist of the International Monetary Fund. Specifically, focus on the final section of the article, “The Way Out.” I was struck by Johnson’s discussion of the inherent problems of large-scale banks. He employs a simple logic:

*Oversize institutions disproportionately influence public policy; the major banks we have today draw much of their power from being too big to fail. Nationalization and re-privatization would not change that; while the replacement of the bank executives who got us into this crisis would be just and sensible, ultimately, the swapping-out of one set of powerful managers for another would change only the names of the oligarchs.*

He goes on to argue that banks should be sold in “medium-size pieces, divided regionally or by type of business.” If impractical, they could be sold whole with the mandate that they be broken up shortly. This, he argues, is the best way to limit power in an essential sector of the economy. “Of course,” he adds, “some people will complain about the ‘efficiency costs’ of a more fragmented banking system, and these costs are real. But so are the costs when a bank that is too big to fail explodes. Anything that is too big to fail is too big to exist.”

I also encourage you to read the interview with President Obama in the May 3, 2009, *New York Times Sunday Magazine*.<sup>2</sup> The President has some encouraging things to say, but I can’t help but feel disappointed in the overall tone and substance of his responses. He says, in essence, “We’ll be fine with a bit more regulation.” He seems convinced that we should just duct-tape our financial/monetary system back together, and reacquaint ourselves with a strong and powerful Wall Street (oligarchy?) as a foregone conclusion. President Obama’s choices for key leadership positions in the administration reflect these views, in particular his choice of Mary Schapiro as chair of the Securities and Exchange Commission (SEC). Schapiro has functioned as a steadfast proponent of Wall Street, and most recently as the head of Financial Industry Regulatory Authority (FINRA), the industry trade association. Obama’s other choices also have many direct ties to the big commercial and investment banks.

I urge you to draw your own conclusions. Certainly no one has a crystal ball, and no one can claim to know the best path to pursue at this point. The biggest issue for me, however,

---

1 <http://www.theatlantic.com/doc/200905/imf-advice>.

2 <http://www.nytimes.com/2009/05/03/magazine/03Obama-t.html>.

is scale, and its relationship to power. Mostly from my study of American history, I'm a fan of small, entrepreneurial, decentralized marketplaces; networks of investors and companies connected through relatively little financial intermediation.

I do not think a \$2 trillion bank (such as JPMorgan Chase) is much good at innovation anyway. And let's face it, services such as online bill pay are weak reasons not to switch to a community bank or credit union if you really think it through. With a giant transnational bank, you have no idea which loans your money is being used for, or where your funds reside at any given time. Plus, how can you trust "collateralized debt obligations" or other "structured" financial vehicles that are designed only to help the bank become a larger and larger pile of money?

In addition to the big banks, let's consider the mutual fund industry. There is absolutely no reason why the world needs more than 8,000 different funds, most charging fees well in excess of the value they create. Regarding brokers, Merrill Lynch and others have been exposed as hopelessly riddled with conflict-of-interest and incentive-compensation problems.

But Wall Street will live on. Large-scale capital markets will exist, for good reason, for companies and industries that require centralized R&D, manufacturing, and distribution. Think airplane engines, pharmaceuticals, semiconductors. Hopefully investors will reward only the most transparent and honest of the remaining players.

As important, I think we will also see the growth of diversified, capital markets, not dependent at all on Wall Street, and designed to support small- and medium-sized, triple-bottom-line companies in sectors such as food, energy, clothing, building materials, and a whole range of household products. With this approach, people will save more, spend a higher percentage of their overall income on basic needs, keep their investment strategies simple, and their money closer to home.

Getting back to the issue of scale and power, these regional capital markets will ensure a healthy democracy in the United States. Every business student of the post-World War II era has learned about efficient flows of capital. A fragmented market will invariably consolidate, we have been taught.

But I do not think this is true anymore. The twenty-first century will have many fragmented markets because investors and consumers will demand authenticity and real innovation from the companies they support. A growing number of people are connecting the dots as a result of the current financial crisis.

If today's capital markets can be described as complex, opaque, and anonymous—based on short-term outcomes—then we are beginning to see more financial transactions that are direct, transparent, and personal—based on long-term relationships.

In the years to come, there will be significant growth of:

- Small-scale community banks;
- Holding companies for privately held, triple-bottom-line businesses; and
- New funds that redefine venture capital and the notion of an "exit strategy."

Who will be the most powerful change agents in this emerging financial system? The following are three individuals that have personally inspired me:

Judy Wicks first coined the term “living return,” as opposed to “maximum return.” Owner and founder of Philadelphia’s 25-year-old White Dog Café and cofounder of the Business Alliance for Local Living Economies (BALLE), Wicks is a role model and national leader in the local, living economies movement. She is also president of White Dog Community Enterprises, a nonprofit 501(c)(3) dedicated to building a local food system and living economy in the greater Philadelphia region.<sup>1</sup>

Leslie Christian has reimaged the purpose of a corporation as the chair of Upstream 21, an innovative holding company model designed to build natural, social, and economic capital within communities. In the corporate charter, Christian and her colleagues defined the best interests of Upstream 21 to include consideration of employees, the environment, long-term and short-term interests of shareholders, customers, and suppliers, and the communities in which the company and its subsidiaries operate.<sup>2</sup>

Penelope Douglas is a pioneer in channeling funds to small businesses in low-income communities. Cofounder and president of Pacific Community Ventures, Douglas launched PCV’s community development investment assistance model. She also founded the first community venture fund on the West Coast and was founding chair of Juma Ventures, a nonprofit organization that develops and operates businesses designed to provide job opportunities to economically disadvantaged teens.<sup>3</sup>

We can only hope that more women reach the leadership ranks of financial institutions. It may be our best plan for the future. The fact is women have a more advanced intuitive understanding of the challenges we face as a species, including ecological stewardship, food and energy security, the widening gap between rich and poor, education reform, and community health, among others.

Thankfully, more women are demanding that these values be reflected in their investments. They have been served poorly by brokers and bankers over the years, as these statistics show:

- 59 percent of women feel misunderstood by food companies;
- 66 percent of women feel misunderstood by health care companies;
- 74 percent of women feel misunderstood by automotive companies;
- 84 percent of women feel misunderstood by financial services companies;

By 2010, women are estimated to account for one-half of the private wealth in America, approximately \$14 trillion. This number is projected to climb to \$22 trillion by 2020. Women

---

1 [http://www.smallisbeautiful.org/publications/wicks\\_06.html](http://www.smallisbeautiful.org/publications/wicks_06.html).

2 <http://www.upstream21.com/about.html>.

3 <http://www.pacificcommunityventures.com>.

control 48 percent of estates worth more than \$5 million.<sup>4</sup>

My friend Sallie recently moved from California to a small town in upstate New York. Soon after arriving, a broker from Merrill Lynch contacted her, wondering if she had considered shifting her investment portfolio given current market conditions “Yes,” she said. “In fact, I was thinking about making a small direct loan to the local family farm that runs our community supported agriculture (CSA), over and above what I pay them annually for the vegetables. I think it’s a good long-term investment in my community. And it will provide an even stronger relationship with a key source of our food. How would I do it? Any ideas?” The broker discouraged it, then gave her a sermon on diversification in public equities and bonds.

Should Sallie pay close attention to the risks associated with this potential investment? Of course. But what would it look like if she and others invested a set percentage of their assets in local, triple-bottom-line businesses, effectively creating a new asset class? Why should this be a crazy idea?

*Don Shaffer is president and CEO of RSF Social Finance. Inspired by the work of Rudolf Steiner, RSF has made more than \$200 million in loans and more than \$90 million in grants since 1984 to organizations in the areas of food and agriculture, education and the arts, and ecological stewardship. Prior to joining RSF, Don served as executive director of the Business Alliance for Local Living Economies (BALLE), as well as interim executive director of Investors’ Circle. He remains a trustee of BALLE, in addition to being on the boards of Social Venture Network and Comet Skateboards.*

---

4 Data from 2007 survey, Buying Influence, Inc.

