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POSITION PAPER

Impact Investing as a societal refocus of Venture Capital. The perspective of mature economies.

impact Lab INVESTING

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Veronica Vecchi, Francesca Casalini, Stefano Caselli

Impact Investing Lab, SDA Bocconi School of Management

Introduction

Impact investing is often associated to the development of new businesses, even though its scope is larger and it embraces other asset classes.

In this paper we analyse impact investing as a new trend in the venture capital market, especially in mature economies like Europe and the United States, where social needs to be tackled are not necessarily at the very bottom of the pyramid, where public policies still provide an answer, but they are spread across the new poor, such as young families with temporary jobs, elderly people with low pensions, young unemployed people still supported by their families, middle-aged unskilled workers who lost their job, persons with disabilities. So far states' welfare policies have looked after the needs expressed by these people. However, in the last years, the economic crisis and other priorities (for example the terrorism as well as the migrant emergency) have caused a reduction of budget available for social policies, thus creating an unmet social demand.

On the other side, there is a generous liquidity available among private investors – according to McKinsey Global Institute (2014), 200 trillion US Dollars are invested in financial assets, of which a consistent proportion, 56.4 trillion US Dollars, is in the hands of high net worth individuals (HNWIs) who increasingly seek to achieve more than monetary returns with their investments and consider driving social impact important (Capgemini, 2015). This financial wealth is striving to be channelled into alternative and attractive investment segments, beyond double digit expected and not always gained returns in traditional market sectors. In particular, in the venture capital space, the poor returns earned by investors and fund managers in the hi-tech sector over the past decade have led many experienced venture capitalists to left the market looking for opportunities to give back, bringing their *forma mentis* and expertise in the social field.

The paper analyses the development of impact investing, at least that part which is based on equity investments in new enterprises, with the lenses of venture capital theory and practice. It is structured into 4 main sections: the first one is focused on the investment target of impact investing and it introduces the concept of societal impact enterprise; the second one explains the investment approach, showing interesting linkages between impact investing and venture capital; the third one analyses how some public financial facilities dedicated to the development of venture capital market in Europe and in the U.S. have created special initiatives for the impact investing segment; the fourth and last one challenges on possible evolutions of impact investing.

1. Investment target: societal impact enterprises

The generation of financial returns alongside the intentionality and additionality of the social and environmental impact, which is the distinguishing feature of impact investing (Brest & Born, 2013; Rodin & Brandenburg, 2014), raises concerns about the targets of this novel investment approach. The debate among academics and practitioners at international level is often focused on the compatibility of the wealth-creation, which is an imperative for profit organizations, with optimal social impact. The existence of failures in the marketplace has traditionally led to a trade-off between social and financial returns, suggesting that the former is always at the expense of the latter (Austin, Stevenson, & Wei-Skillern, 2006; Boschee, 1998; Dees, 1998; Karnani, 2011).

However, in the last decades, organizations operating in the social sector have created models for catering to pressing societal needs that existing markets and institutions have failed to satisfy (Di Domenico, Haugh, & Tracey, 2010; Seelos & Mair, 2005).

In this framework, to capture the target of traditional investment approaches within the social sector, pursued by philanthropy and venture philanthropy[1], and to understand the

[1] Venture Philanthropy (VP) has emerged during the past decade as a high engagement approach to social investment and grant making across a range of organizations with a societal purpose, from charities and non-profit organizations through to socially driven businesses, focused on delivering long- term and sustainable societal impact. The VP approach includes the use of the entire spectrum of financing instruments (grants, equity, debt and hybrid financing) and pays particular attention to the ultimate objective of achieving a social impact. Thus VP includes both social investment

differences with impact investing, it may be useful to refer to the concept of merit goods (Musgrave 1959), defined as products whose consumption generates positive externalities on society but many people do not have the ability and willingness to pay (Musgrave 1987). Musgrave (1987) deemed merit goods desirable "*where evaluation of a good ... derives not simply from the norm of consumer sovereignty but involves an alternative norm*", i.e. the concept of need deriving from the public benefits generated when such a good is consumed. Examples of merit goods are health services, housing and education.

Governments have traditionally funded and incentivized the consumption of these goods, providing them free of charge or at political prices to those people that could not afford to buy them. Also private organizations operating in the social sector, like non-profit and social enterprises, have supplied them, trying to fill the gap generated by the state welfare policies (Thompson, Alvy, & Lees, 2000).

However, in the last years, the instability of the economic system has forced many governments to cut their budget, retrenching more and more the costs for the provision of some merit goods. On the other way, traditional not-for-profit organizations and social enterprises lack access to stable and relevant capital in order to build a sufficient scale to address the social and environmental challenges the contemporary communities are facing (Bloom & Chatterji, 2009; Bradach, 2003; Cohen & Sahlman, 2013; Zahra, Gedajlovic, Neubaum, & Shulman, 2009). The consequence is sub-optimal provision of merit goods, which may eventually result in a gap of value generated for the society.

Impact investing is an investment niche that has emerged to fill this gap, by leveraging the innovation capacity of a new generation of entrepreneurs with the mission to build sustainable, replicable and scalable business models, able to attract capital through a return-driven growth of assets (Grabenwarter & Liechtenstein, 2011).

Resembling what Schumpeter's (1934, 1942) entrepreneurs perform in the world of traditional business, entrepreneurs in the impact investing field introduce newer and more efficient systems, products and processes with the aim to answer to emerging societal challenges. These innovations can be defined as "catalytic" (Christensen, Baumann, Ruggles, & Sadtler, 2006) as they create systemic social change by offering products and services that are more valuable and less costly than existing alternatives. This approach has the potentiality (and

and high engagement grant making. There is no single global definition of VP, and the concept is in continuous evolution, along with its practice (Buckland, Hehenberger, & Hay, 2013).

in some cases already demonstrated) to transform merit goods into private commercial goods, for which end-users are able and willing to pay.

This is the essential prerequisite that allows creating social impact with financial profit within organizations that can be defined *societal impact enterprises*, which are in the end the investment target of impact investing. In mature economies like the Western ones, these enterprises mainly operate in segments traditionally or potentially served by the welfare state system, i.e. healthcare, education housing and employment, serving the society at large and not necessarily in its most deprived and poor segments, which remain a core focus of governments, supranational organizations, foundations, charities and social enterprises.

For s*ocietal impact enterprises* the additional impact and the financial return on invested capital are both part of the same business mission and thus the social objectives are never pursued at the expenses of the profitability, as it may happen in the field of *social enterprises*, which put the impact at first, whilst the financial sustainability and organizational resilience are mainly vehicles for better pursuing the social mission (Austin et al., 2006; Seelos & Mair, 2005). The business model of *societal impact enterprises* is based on the generation of revenues by selling new services and products; on the contrary, there is a wide literature that defines the *social enterprise* as a not-for-profit organization (e.g. Austin et al., 2006; Dees, Emerson, & Economy, 2004) or as an organization that, despite the level of sophistication, widely relies on donors money (Dees, 1998; Smith & Stevens, 2010). In that *social enterprises* are typical targets for venture philanthropy investments, whose approach includes both the use of reimbursable capital and grants, which are provided alongside multi-year non-financial support.

A direct consequence of these differences is the measurement of the performance. In traditional business environment, value is created when customers are willing to pay more than it costs to produce the good or service and therefore the profit (revenue minus costs) generated is a reasonably good indicator of the value created (Dees, 1998). In *societal impact enterprises*, as the impact is strongly embedded in the commercial business model, if they are able to serve a sufficient number of customers who pay for their products or services, meaning that they are able to meet the societal demand, then they will be both profitable and impactful. Hence, their capacity to generate a sustainable profitability, which also means fueling investments through a reinvestment of surplus to sustain their scaling up, can play not only as a measure of value creation but also as an indirect measure of societal impact. It is important to underline that the concept of scaling in impact investing is different, as it is not only referred to the growth in social value (Taylor, Dees, & Emerson, 2002) but it becomes also a prerequisite of profitability.

This argument does not pull out impact investing from the impact measurement challenge, which is a fundamental prerequisite that distinguishes impact investing from traditional business initiative[2]. However, as said, it is embedded in the business model and therefore less challenging compared to *social enterprises,* for which impact measurement is the main performance measure, which is assuming more and more relevance to win the game of philanthropic-based funding attraction (Ebrahim & Rangan, 2014; Kanter & Summers, 1994). A recent survey run by Barclays (2015) shows that "*only the 68% of people interviewed want to receive progress reports on their impact investments. Not all investors, however, necessarily expect social returns to be measurable – 48% say this would not put them off impact investment, against 47% who say it would*".

Even though boundaries are blurred and we don't want to fall into a definitions trap, Table 1 summarizes the main peculiarities in terms of mission, business model, funding approach and performance measurement, of non-profit organizations, social, societal impact, and commercial enterprises.

Table 1 – How the targets of impact investing differ from social and commercial enterprises

	Nonprofits, NGOs, charities	**Social enterprises**	**Societal impact enterprises**	**Commercial enterprises**
Mission	Creating additional social value for the target population	Creating additional social value for the target population reaching sustainability in the long-run	Creating profitable operations while generating additional social impact from serving a certain societal demand	Creating profitable operations resulting in private gain; the social impact is created through jobs, CSR or specific good and services

[2] Even commercial enterprises, however, can have transformative social impacts (Austin et al., 2006).

Business model	Mix of free of charge and priced services (hybrid models); costs and investments mainly covered by grants and donation	Self-sustainability as a vehicle to reach impact; margins from operations, when generated, are reinvested. Investments are funded through a mix of grants and refundable loans	Products and services for which consumers are willing to pay more than production costs; product and process innovation and reliability to reach profitability to be reinvested to reach the scale	Products and services for which consumers are willing to pay more than production; scalability and replicability of the model to reach economy of scale; product and process innovation to increase the profitability and the shareholders' value
Funding approach	Philanthropy	Venture Philanthropy	Impact Investing	Traditional financing, such as venture capital or other forms on the basis of the company's stage
Performance measurement	Impact measurement	Impact measurement	Profit as a measure of value creation, impact measurement to prove the additionality created for the society	Profit as a measure of value creation

Source: Authors

2. Investment approach: a venture capital like approach

Venture capital – defined as independent, professionally managed pools of capital that focus on equity or equity-linked investments in young, high growth, privately held companies[3], where the investor is a financial intermediary who is typically very active also as a director, an advisor, or even a manager of the firm (Gompers & Lerner, 2001) – emerged as the dominant form of equity financing in the United States for high-technology businesses in the 1980s and 1990s, being responsible for a greater share of US industrial innovations in these decades (Kortum & Lerner, 2000). And this is true also for Europe, where venture capital is thought to account by now up to 12% of European industrial innovation (Popov & Roosenboom, 2009).

[3] Venture capital is a segment of private equity investments that focuses on young companies that require money to pursue their initial growth targets. The second major segment of private equity is the "LBO/MBO" (leveraged buyout or management buyout) segment, which consists of private equity investments in established companies that operate in mature industries and require money to solve capital structure problems and/or to pursue additional growth targets.

Just as the formation of the venture capital industry ushered a new approach and mindset toward funding innovation within the hi-tech sector, impact investing has started to adopt the same investment approach to harness entrepreneurship and capital markets to drive social improvement (Cohen & Sahlman, 2013).

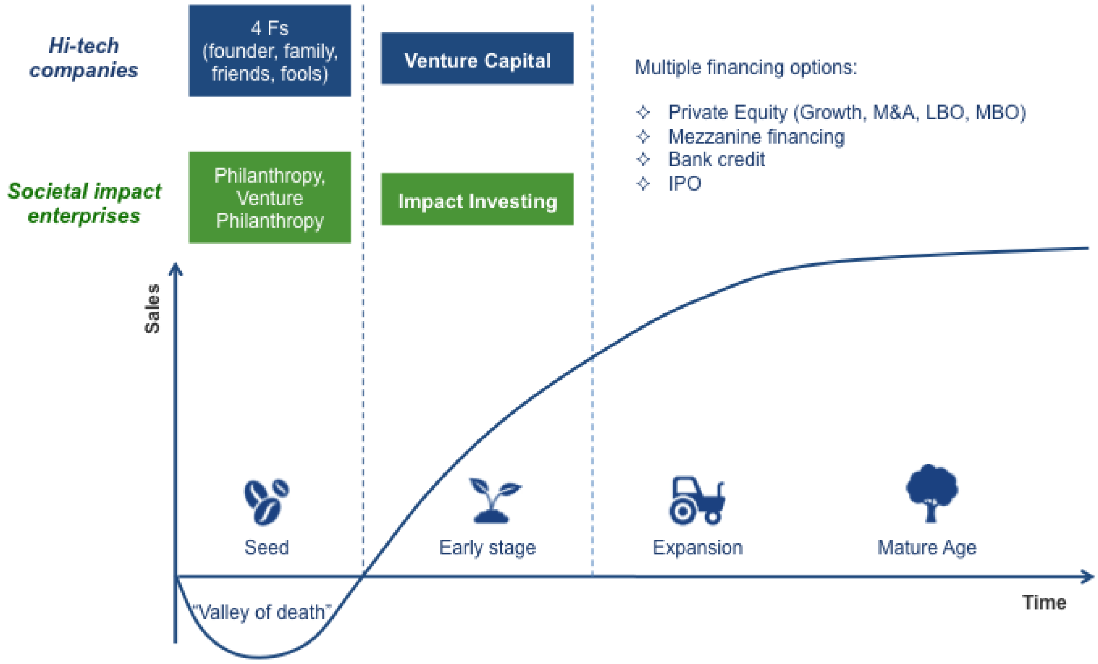
In fact, likewise venture capital, impact investing acts as an intermediary which targets firms that are small, young and privately held, providing them with equity or quasi-equity financing together with an active involvement and an hands-on approach (MacMillan, Kulow, & Khoylian, 1989). Unlike venture capital, impact investing does not fund new technology-based solutions but supports the scaling-up of social innovations in sectors such as healthcare, education, housing and employment, directing resources towards those businesses that we have defined as *societal impact enterprises*.

Continuing our parallelism, both venture capital and impact investing provide early stage financing, when firms mostly need equity capital to validate and scale their business model. However, the type of financial resources that can be accessed varies in each stage of development, on the basis of needs and levels of risk.

In traditional enterprises ecosystem, seed financing is usually provided by informal investors, the so-called 4Fs: founders, family, friends and foolhardy investors (Bygrave, Hay, Ng, & Reynolds, 2003). In the impact investing segment, philanthropy and venture philanthropy resources may have the same role played by 4Fs, creating the playground where innovative and impactful business models are seeded, tested and nurtured, before being ready to scale through the financial and managerial support of impact investing.

Figure 1 compares and shows the differences between the development path of a hi-tech company and a societal impact enterprise, from the seed to the maturity stage, where venture capital and impact investing cover the segment of early stage financing, while the exit can be pursued through different approaches, like for example by selling the shares to later stage funds or the company entrepreneur or its management.

Figure 1 - Impact investing, venture capital, and early stage financing



Source: (Vecchi, Casalini, Balbo, & Caselli, 2015)

The application of venture capital financial model to impact investing is confirmed by the latest GIIN and J.P. Morgan figures, according to which 63 percent of the total capital globally available in the impact investing arena are managed by fund managers and mainly invested in companies in their venture and growth stage through private equity or equity-like instruments (respectively, 35 percent and 41 percent of total global assets under management in 2014) (The GIIN & J.P. Morgan, 2015). This is even more evident for impact investing at the European level, where a consistent proportion of the fund managers of European impact investing funds have a background in traditional private equity or venture capital sector. Among them, for example, Bridges Ventures, pioneer impact investing firm in the UK, with more than £ 500 million of assets under management and now one office also in the U.S., was co-founded in 2002 by Sir Ronald Cohen[4] together with some of the most successful UK's private equity firms and entrepreneurs – Apax Partners, 3i, Doughty Hanson and Tom Singh. Another UK fund, Impact Ventures UK, was launched in 2013 by Berenberg Investment Bank and it is led by Richard Brass, the head of the Bank's UK clients. In France, Olivier De Guerre, Managing Director at Credit Suisse Asset Management, launched PhiTrust Partenaires in 2003 and then,

[4] Sir Ronald Cohen is the director of Social Finance UK and the Founder Chair of The Big Society Bank. He was a co-founder and chairman of Apax Partners, one of the world's leading private equity investment groups, and is considered the "father of British Venture Capital".

in 2012, PhiTrust Impact Investors, the branch dedicated to investments able to combine social and financial returns. In Germany, Johannes Weber, serial entrepreneur, together with Florian Erber, former investment manager at Wellington Partners Venture Capital, launched the Social Venture Fund in 2010. In Spain, Vivergi Fund was founded in 2014 by Carlos Tejera, with 25 years of experience in investment banking and private equity. The case of Oltre Venture in Italy provides further evidences on the fund managers' shift from traditional venture capital space to impact investing. Its founder, Luciano Balbo, has been a private equity entrepreneur since 1980s, being a pioneer in the Italian private equity and venture capital industry and contributing to the birth and first development of venture philanthropy and impact investing in Europe and in Italy (Vecchi, Casalini, Brusoni, & Cusumano, 2015).

Also in the U.S. many impact investing funds have been funded and managed by managers with long experience across venture capital and entrepreneurship, and examples includes Acumen, Elevar Equity, Sonen Capital, Root Capital, SJF Ventures, and many others. However, a large proportion among the American funds does not invest in companies based in their own country, as most European funds do, but targets solutions for the bottom of the pyramid in emerging economies. As this is not the focus of this paper, as we have declared since the beginning, Table 2 reports a selection of impact investing funds based in Europe and the U.S. which invest only in this two geographic areas; European and American funds that target emerging countries have been excluded.

In any case, the European and American experience suggests that Impact investing seems to be an attractive domain for venture capital market players looking for new investment segments beyond the high-tech sector and a recent analysis carried out by the GIIN and Cambridge Associates has exhibited strong performance of this investment approach, returning a pooled IRR[5] of 6.9 percent to investors between 2000 and 2010[6] (Cambridge Associates & The GIIN, 2015). Further empirical results have also shown that impact investing may benefit from the experience of traditional venture capital, since fund managers with a background in venture capital have obtained returns that are 7.6 percent higher, on average, than those reached by fund managers with other backgrounds (see Box 1).

[5] Internal Rate of Return, a widely used return rate to measure and compare the profitability of investments.

[6] The analysis comprises 51 impact investing funds, which operate across geographies and sectors and were launched between 2000 to 2010. However, due to the raise of impact investing in more recent years, the 50% of funds in the entire sample were raised from 2008 to 2010.

Table 2 – Major impact investing funds operating in Europe and in the U.S. which target *societal impact enterprises* located in developed countries

Fund	Location	Year of inception	Sector focus	Geography focus	Founder / Management Previous Experience	Website
Phitrust Impact Investors	Europe (France)	2012	Housing Disability Education Renewable Energies	France, Europe	Olivier De Guerre, Managing Director at Credit Suisse	http://www.phitrustimpactinvestors.com/
Bon Venture	Europe (Germany)	2003	Housing Disability Education Nutrition Environmental protection	Germany, Austria and Switzerland	Erwin Stahl, more than 20 year experience in venture capital (Wellington Partners, Upside Ventures)	http://www.bonventure.de/en/home.html
Social Venture Fund	Europe (Germany)	n/a	Education Social integration Ageing population Long-term unemployment Healthcare	Europe	Johannes Weber, serial entrepreneur Florian Erber, investment manager at Wellington Partners	http://www.socialventurefund.com/en/#home
Oltre Venture	Europe (Italy)	2006	Education Healthcare People-oriented services	Italy, Europe	Luciano Balbo, more than 20 year experience in venture capital (founder of B&S Private Equity and General Director at Finnova the first Venture Capital Company in Italy)	http://www.oltreventure.com/
Vivergi	Europe (Spain)	2014	Food and agriculture Health and wellness Education Environment	Spain	Carlos Tejera, 25 years in investment banking and private equity (Ambar Capital y Expansion, Gala Capital Partners) Rodrigo Aguirre De Carcer, Managing Director of eBay Spain	http://www.vivergi.com/
Impact Ventures UK	Europe (UK)	2012	Housing, Employment, Mental health	UK, Europe	Richard Brass, head of UK clients at Berenberg Investment Bank	http://www.impactventuresuk.com/
Bridges Venture	Europe (UK) and US	2002	Underserved Markets, Health and Well-being, Education and Skills and Sustainable Living	Europe, US	Ronald Cohen, more than 20 year experience in private equity and venture capital (founder and chairman of Apax Partners)	http://bridgesventures.com/
Renovus Capital Partners	US	2010	Education	US	Brad Whitman, Atif Gilani and Jesse Serventi, 34 year cumulated experience in private equity	http://www.renovuscapital.com
SJF Ventures	US	1999	Clean energy Asset recovery Food Education Health	US	Dave Kirkpatrick, serial entrepreneurs Rick Defieux, venture capitalist for over 30 years	http://sjfventures.com
Bluehenge Capital Partners	US	n/a	Development of rural or underserved communities	US	Nemesio J. Viso and Ari David Kocen, both senior managers at Stonehenge Capital Company, with 25 years of banking and investment experience	http://www.bluehenge.com/index.html
Small Business Community Capital	US	n/a	High growth SME's across different sectors that can also deliver opportunities for societal transformation	US	Jay Garcia, 25 year experience in private equity with a focus on lower middle market companies	http://www.sbccfund.com/index.html#top

Source: Authors on the basis of the information available on the funds' websites as of January 2016

Box 1 - The Influence of Managerial Background on the Financial Performance of Impact Investing Funds

A wide literature about private equity has investigated the correlation between past and future performance and there is a general consensus on the role played by fund managers' experience in achieving higher returns (Diller & Kaserer, 2009; Gottschalg, Phalippou, & Zollo, 2003; Kaplan & Schoar, 2005; Ljungqvist & Richardson, 2003), since managers with an excellent track record are generally able to raise more capital and likely to select better investment opportunities (Gompers, Kovner, Lerner, & Scharfstein, 2005).

Building on private equity literature, we have investigated whether the correlation between the background of the managers and their current performance is valid also in impact investing and specifically whether or not managers with previous experience in venture capital are more successful also within the impact investing field.

To test our hypothesis, we have built a sample of impact investing funds by using two main sources, Impact Base powered by the GIIN and Preqin. The first is an impact investing specific databases which collects information about the funds operating in this industry with reference to strategy, target return and assets under management; the latter is one of the most comprehensive private equity database containing information about funds in the market, investors, fund managers, deals and returns.

We first sourced the list of impact investing funds from Impact Base, where in all 138 eligible funds were available at the end of 2014. Then, since Impact Base reports only the target and not the actual return achieved by each fund, we tried to derive this data and other necessary to perform the analysis from Preqin.

However, as there is an inherently lack of information about the internal rate of return of private equity funds (Brander, Du, & Hellmann, 2015; Cumming, Grilli, & Murtinu, 2014; Hochberg, Ljungqvist, & Lu, 2007), and this issue is even greater in impact investing due to the nascent stage of the field[7] and its still blurred boundaries, we have gathered sufficient data for 33 funds only[8]. Alongside the actual IRRs, we derived from Preqin other useful information such as the firm managing the fund, the responsible fund manager, his/her former job.

As the sample was too small to be analyzed through a more sophisticated methodology,

[7] Funds of vintage year 2011 or later do not have a sufficient track record to enable meaningful analysis of performance. A fund's vintage year is its legal inception date, as noted in its financial statements.
[8] Even though quite small, our sample is in line with the research carried out by the GIIN and Cambridge Associates that analyzes the performance of 51 impact investing funds (Cambridge Associates & The GIIN, 2015)

we calculated the main descriptive statistics splitting the sample in two sub-groups, i.e. the funds where responsible managers have previous experience in private equity and venture capital and the funds managed by people with different backgrounds, i.e. with former jobs in international or multilateral organizations, foundations, enterprises – either social or commercial – with no entrepreneurial and/or investment responsibilities.

As summarized in Table 3, the calculated mean IRRs show that managers who shifted from private equity and venture capital have generally outperformed other managers, achieving returns that are higher, on average, by 7.57 percent.

This finding is coherent with the private equity literature and seems to support our view of impact investing as a new attractive domain for experienced and successful venture capitalists, who want to refocus their activities.

More accurate results could be achieved once the industry will be more mature, with more funds available in the market and more detailed information about the investments done.

Table 3 – Average IRR by background of fund managers

Total number of funds = 33		
	Funds where managers have a PE/VC background n = 13	**Funds where managers have other backgrounds** n = 20
Mean IRR	7.88%	0.31%
Standard deviation	0.1106	0.1100
Median	6.00%	1.80%

3. Building the market through financial public facilities rooted in the VC experience: EIF and SBIC

As discussed in the previous section, venture capital – thanks to its ability to detect new ventures and its direct involvement in the management of the enterprises funded – is widely recognized as a form of financial intermediation that can be a catalyst for innovation, enhancing the generation of new innovative firms (Florida & Kenney, 1988; Hood, 2000; Kortum & Lerner, 2000; Lerner & Watson, 2008). However, since the risk embedded in early stage financing is high, as well as the appraisal and monitoring costs, which are fixed regardless of the size of the deal, small and young enterprises face significant difficulties in accessing finance to pursue their initial growth targets, which is generally known as “equity gap” (HM Treasury, 2003; Karsai, 2004; Mason, 2009).

As the development of entrepreneurship represents one of the main priorities for policy makers in many countries, over the last decades a great amount of public resources have been channeled into venture capital programs aimed at closing the equity gap and make financing available for high-growth start-up companies (Bates, 2002; Colombo, Cumming, & Vismara, 2014; Cumming & MacIntosh, 2006; Da Rin, Nicodano, & Sembenelli, 2006; Lerner, 2000).

Governments across the world have supported the development of the venture capital market mainly through the creation of venture capital funds, wholly public or public-private, or funds of funds, which invest in other funds (Mason, 2009). Among them, the largest and most famous public program worldwide has been the multi-billion SBIC Program managed by the Small Business Administration (SBA)[9], which has contributed to many of the technology innovation created in the US since 1960s. As in the US the SBIC Program, the European market has been widely nurtured by the European Investment Fund (EIF)[10], which has been the leading investor in venture and growth capital funds in Europe, providing equity resources to 433 vehicles since its inception in 1994[11], backing emerging and established venture capital funds, as well as co-investing with business angels and family offices and addressing the need for financing of technology companies. Despite more recent and smaller compared to the SBIC, the EIF has been the most effective program worldwide to sustain the growth of new ventures, since the enterprises financed by the funds supported by the EIF have generally achieved better performances (measured in term of successful exits) than those funded by any other program, even those funded under the SBIC (Caselli, Vecchi, & Casalini 2015). The effectiveness of the EIF is due to its proactive role played in the selection and monitoring of the venture capital funds supported. On the contrary, the access to SBIC support happens on the basis of the fulfillment of certain eligibility criteria. However, more in general, an intermediated support to the

[9] The Small Business Investment Company (SBIC) Program was created by U.S. Congress in 1958 and managed by the SBA to develop the venture capital market in the U.S. The SBA does not invest directly into small business through the SBIC Program, but provides long-term capital in the form of a loan facility to qualified and fully private venture capital funds, accredited at the SBA to get the status of a SBIC. The SBA invests with a leverage of up to 2:1 which means that for every 1 US Dollar an SBIC raises from a private investor, the SBA will typically provide 2 US Dollars of debt capital. SBA refinances future loans through securitizations with Federal Government credit enhancement. Since its beginning, the SBIC Program has provided 23.8 billion US Dollars of loans to licensed SBIC funds and, thanks to the leverage effect, deployed over 67 billion US Dollar to more than 166,000 small U.S. companies.

[10] The EIF provides equity financing to already existing venture capital funds through the mechanism of a fund of funds; the EIF is a *pari-passu* anchor investor, which means that it is typically the first investor in any round, providing subsequent investors a degree of confidence. The *pari-passu* rule requires that all the investors, including EIF, share exactly the same upside and downside risks and rewards and holding the same level of subordination, and exiting from the eligible beneficiary on the same terms and at the same time. Furthermore, EIF may not participate in funds where funding from non-market-oriented investors exceeds 50% of the fund's total funding.

Since its inception, the EIF has deployed 4.4 billion Euros to 433 venture capital funds, which mobilized capital from private investors of others 4.4 billion Euros, creating a twofold leverage effect and maximizing the impact on European businesses.

[11] EIF's equity investments since inception as of December 2015; data available at http://www.eif.org/what_we_do/equity/eif-equity-portfolio.pdf

venture capital market, as operated by the SBIC through loans or by EIF through equity co-investment to venture capital funds, has proved to be more effective than any other form of public intervention in the venture capital market, as, for example, through public or public-private venture capital funds (Caselli et al., 2015).

More recently, as social innovation has emerged as an outstanding paradigm to provide new solutions and instruments to cope with the economic crisis and other social problems which affect communities globally (Mulgan, Tucker, Ali, & Sanders, 2007), the European Union included it as a target in its new strategic plan, the Europe 2020 Strategy (European Commission, 2010). Consequently, the EIF, on the basis of its experience accumulated in the VC market, has launched the Social Impact Accelerator (SIA), an equity facility dedicated to impact investing as the most suitable investment approach to sustain the generation of innovation for the society at large.

Through SIA, EIF's objective is to become the reference point for impact investing at European level and to leverage its expertise in the venture capital market to build up the existing infrastructure in such a way that this emerging investment approach is placed on a path to long-term sustainability (European Investment Fund, 2014).

Led by Uli Grabenwarter, SIA is set up as a fund of funds with an amount of 243 million Euro, which will provide equity financing to funds in the social impact segment, which strategically target *self-sustainable* and *commercially viable* social enterprises across Europe. SIA defines the targets of impact investing as "*SMEs whose business model serves to achieve a social impact, […] providing an entrepreneurial solution to a societal issue based on a scalable approach*", which corresponds in the end to the description of *societal impact enterprises* presented in this paper.

Beyond simple financial return targets, the social impact funds backed by EIF are required to pursue explicit social impact investment targets at the level of their portfolio companies. However, the target risk adjusted IRR required by the EIF is between 3 and 5 percent, thus clearly excluding pure social or hybrid investments from the scope of SIA.

At the time of writing[12], the EIF has supported five European impact investing funds[13].

As in Europe, also in the U.S. the SBIC Program, leveraging its long experience of driving capital to America's underserved communities and its most innovative sectors, has

[12] January 2016
[13] http://www.eif.org/what_we_do/equity/sia/

launched a dedicated initiative, the Impact Investing Fund, to "*help U.S. impact investing industry build the track record and measurement standards it needs to attract larger pools of capital*". With roughly 200 million US Dollars in yearly commitments, the SBIC Impact Investing Fund is available for funds that maximize financial return for their investors and, at the same time, generate positive social, environmental and economic impact. Accordingly to the Impact Investing Fund policy, eligible SBIC impact investing funds invest in U.S. small businesses operating in areas of national priority such as clean energy, education and advanced manufacturing and located in low-income communities, rural or economically distressed areas. Differently to the EIF, which provides equity capital with the same terms and conditions of the other private investors and expects a target IRR, the SBA requires all the licensed SBIC funds to pay an interest rate on the SBA-guaranteed leverage calculated as a spread on the U.S. 10-year Treasury Rate[14]. To date, there are seven Impact SBICs licensed collectively managing over 600 million US Dollars in assets[15].

4. The way forward

We live in a world awash with capital, according to estimates by the McKinsey Global Institute (2014) reported in the Introduction. We also live in a world of remarkably low interest rates and indeed, if we look at the return history of the venture capital market, the average IRRs returned to investors have not been as high as expected, especially in Europe where the latest statistics report a 10-year horizon IRR[16] of 0.84 percent compared to a 5.03 percent in the US (EVCA, 2014).

Therefore, impact investing may represent a new attractive domain for venture capital investors, looking for new opportunities beyond double digit expected and not always gained returns in hi-tech markets. In Italy, for example, Jobmetoo[17], a societal impact enterprise funded an hearing-impaired entrepreneur who developed an online recruitment platform for persons with disabilities, was refused a 500.000 Euros investment by the impact investing firm Oltre Venture, despite its clear social impact and the promising financial figures, because at that time the first fund Oltre I was almost allocated and was not able to sustain such a large ticket. Nevertheless, the company won a business plan competition and received the same amount

[14] Latest data as of November 2015 report a spread of 0.659% on a Treasury Rate of 2.170%, available at https://www.sba.gov/content/trust-certificate-rates-sbic-debenture-pools
[15] https://www.sba.gov/content/directory-impact-sbics
[16] The horizon IRR allows for an indication of performance trends in the industry.
[17] http://www.jobmetoo.com

from the French – Italian firm 360 Capital Partners, leading venture capital investor in the digital and consumer internet space, which was mainly attracted by the scalability of the online portal and considered the social impact as a way to reach faster the target of users.

This is an example. How many similar cases do exist, whose societal dimension would have been better nurtured by impact investors rather than by mere venture capitalists?

If impact investing really offers, in the mid term, the returns registered in its early stage, it will be able to attract a portion of the enormous liquidity available worldwide stimulating a societal refocus of venture capital. In this eventuality it may become an investment sectorial preference of venture capital funds.

In this perspective, impact investing could also describe the investment approach adopted by certain private for profit companies to diversify their strategy according to the "shared value" paradigm (Porter & Kramer, 2011; Vecchi, Brusoni, & Cusumano, 2014).

An interesting example is represented by the French Group Lafarge, world leader in building materials, which launched the programme Affordable Housing[18] to help populations with low revenue to access housing at an affordable cost. To address this need, Lafarge has developed innovative housing solutions, such as earth-cement bricks, weather-resistant solutions adapted to the topography of slums and ready-mix concrete solutions for collective social housing, together with a microfinance program to enable poor individuals to finance the construction, renovation and extension of their home. It is important to notice that this project is not part of the Group's CSR agenda but it is actually an expansion of their core business. For Lafarge, indeed, the Affordable Housing program is set to become a profitable activity by serving a new target of demand, which today is unmet and very large, as 4 billion people around the world that do not have access to decent housing.

It is evident that we are living a period of disrupting changes towards more sustainability, which is more and more embedded in business strategy and policy agenda (MIT Sloan Management Review & Boston Consulting Group, 2011). The next years will be fundamental to shape impact investing. As Alessandro Manzoni wrote, "*ai posteri l'ardua sentenza*" (meaning, this will be judged by posterity).

[18] http://www.lafarge.com/en/affordable-housing

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