IMPACT INVESTING: Transactional Platforms and the Development of Secondary Markets

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The last two decades have witnessed a great deal of innovation in financial markets that corresponds with a growing interest in what may be referred to as social finance, to capture the wide range of new financial instruments and institutions seeking blended value, or triple bottom line returns. Today, this includes impact investing that is taking much of this earlier activity to scale. Increasingly, as part of their responsible investing strategies, institutional investors are using their influence to ensure that certain environmental, social and governance (ESG) standards be met by the companies and organizations in which they invest (Hoepner & McMillan, 2009). In addition, socially responsible investing (SRI) is shifting from negative screening to proactive investment in order to positively contribute to social and environmental well-being (Clark & Hebb 2004, Kiernan 2009).

This work explores the more recent emergence of impact investing which also refers to investments that create positive social, environmental and economic impact, while generating financial return. In 2010, one study estimated that at least USD 400 billion will be available to fund impact-oriented investments over the next ten years (O'Donohoe et al., 2010). This represents a powerful and promising opportunity for social sector organizations that are currently undercapitalized, and a boost to development, social and environmental sustainability efforts around the world.

While the term Impact Investing, adopted by the Rockefeller Foundation, is relatively new, cooperatives, credit unions and social or ethical banks, to name a few, have been engaged in social finance for many years (Mendell & Nogales, 2011). Credit unions and the cooperative movement have existed for over a century. Well known banks such as Triodos in the Netherlands and Banca Etica have challenged mainstream financial institutions through their successful commitment to social and financial returns. There is also the example of micro-finance which is a recognized asset class, and so on. Notwithstanding this history, as discussed by Mendell and Nogales (2011) , there are at least a few new characteristics associated with the current trend. The first is the increased participation of foundations as investors in the field. In Canada, foundations are encouraged to dedicate at least 10% of their endowment investment to impact investing, both as Program Related Investments and Mission Related Investments (Social Finance Taskforce, 2010). A second new and important feature today is the growth of an equity and quasi-equity market to complement the numerous debt instruments available until now (Mendell & Nogales, 2011), although debt instruments continue to dominate this field. The new and growing participation of institutional investors (e.g. pension funds) along with foundations and high-net-worth individuals, provides a unique opportunity to increase the scale of this activity significantly.

To attract the resources represented by these new potential investors (institutions, individuals) into this market, many challenges must be overcome. These include risk, the development of measurement and evaluation tools, the image of the sector, the lack of appropriate legislative and institutional frameworks, as well as the investment products and maturities that are currently offered (Evenett & Richter, 2011; Mendell & Nogales, 2009; O'Donohoe et al., 2010). The need for intermediaries and financial innovation have been identified by numerous researchers and practitioners. For example, there needs to be a broader range of financial products and choices of capital suppliers or investors that: a) match the diverse needs of organizations – requiring among others, patient capital, and b) conform to the legal structures of non-profits, cooperatives and charities that are limited by their inability to issue shares and for which ownership becomes a key concern (Evenett & Richter, 2011; Mendell & Nogales, 2011). Research also confirms that the vast majority of the “investees” thus far are, indeed, not private enterprises, even though these are certainly part of this evolving landscape that includes new business forms (social enterprise, social purpose business, etc., that can be private or collective enterprises).

In Canada, one example of an innovative impact investment institution providing patient capital to the sector without giving rights of ownership to investors is the *Fiducie du Chantier de l’économie sociale* (Québec) or *Social Economy Trust*, created in 2007. This trust, which by 2011 invested $20.2 million in 64 collective enterprises in different sectors of Quebec, offers quasi-equity with a 15-year moratorium on repayment[1]. It does so effectively, due to its multi-stakeholder structure that mediates between supply of and demand for capital, and provides non-financial support to social economy businesses and/or organizations (cooperatives and non-profits), thus mitigating risk and reducing transaction costs for investors (Mendell & Nogales, 2009). This is an excellent example of the need for the combined need for institutional and financial innovation: a new investment vehicle or product and a new framework for governance. Furthermore, the recognition to focus on both supply and demand, that is, by developing appropriate analytical tools to evaluate the potential market, significantly reduces risk for both the *Fiducie* as investor and for the enterprises which are capitalized. (Mendell & Nogales, 2009; Fiducie[2])

However, innovations such as the Fiducie and others, while providing a sustainable model of investment in enterprises thereby increasing their capacity, are still operating at a small scale relative to the potential size of the market. The need for capital is still not met. As noted above,

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[1] http://www.fiducieduchantier.qc.ca
[2] *Ibid*

structural and/or institutional barriers are creating challenges calling for further innovation. For example, is it possible to envisage a secondary market that will generate the possibility for ongoing capitalization of these enterprises and organizations? Can exit strategies for investors be designed without share capital? What innovations can assure the liquidity that is necessary to be able to capitalize and recapitalize these intermediary entities, allowing them to consolidate and achieve scale?. In traditional capital markets, such liquidity is provided through secondary markets, in which investors can freely trade their stocks, i.e. stock exchanges. There are examples of social impact exchange platforms, established to provide a marketplace both for primary and/or secondary transactions and information on potential investment and investor opportunities. Earlier examples include: Traidcraft's first public share issue ever undertaken by an "ethical business" in 1984; the Bolsa de Valores Sociais[3] (BVS) in Brazil in 2003 that has had an important influence on the Rockefeller Foundation and its current research on the feasibility of a global social capital market undertaken in the UK (Mendell & Nogales, 2009). Triodos Bank's Ethical Exchange ETHEX[4] was established to coordinate ethical public offerings (EPOs) in 2004 and the South African Social Investment Exchange[5] (SASIX) was created in 2006 to sell shares to investors online. Impact Partners was Asia's first online platform launched in 2011. Impact Partners and Mission Markets (US) launched Impact Investment Exchange Asia[6] (IIX) to provide access to impact investment capital to social enterprises across the Asia-Pacific region. NeXii[7] South Africa is a hub for intermediaries to allow all stakeholders to participate through exchange portals and platforms – creating tiered "marketplaces" for different classes of impact investors and with the Stock Exchange

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[3] http://www.bvsa.org.br
[4] http://www.ethex.org.uk
[5] http://www.sasix.co.za
[6] http://www.asiaiix.com
[7] http://www.nexii.com

of Mauritius (SEM), is preparing the launch of the *iX* – the world's first impact investing exchange board to be listed on public capital markets with full regulatory approval. FAST has created an online 'financial marketplace' platform for SMEs to identify sources of investment capital. ImpactBase[8] is an online database created by GIIN in collaboration with Imprint Capital. The Kenya Social Investment Exchange[9] (KSIX) was created to attract foreign investors into the East African impact investment market. Like these, many other initiatives will, no doubt, emerge.

The purpose of this paper is to identify and analyse several transactional platforms or social capital markets and whether they are creating a space for secondary transactions, which would provide investors with an exit strategy, generate liquidity for investors to be able to meet the capital requirements of enterprises/organizations, and establish a more mature and coordinated marketplace. Specifically, we will address the potential and the limits of existing exchanges and whether steps are being made to move towards the development of a social stock exchange. In so doing, we will also note some of the more critical evaluations of thistrend that have been identified by important leaders in the field who propose alternative means to address the need for long-term capital, a sine qua non for these hybrid enterprises to achieve scale. In other words, is the ownership conundrum an impermeable barrier to developing a fully fledged social stock exchange given the large presence of non-profit enterprises? Can the needs for liquidity be met through other means such as bonds, for example? Our paper will address the changing corporate form that is trying to break down the ownership boundary by legislating a new company legal structure (e.g. community interest companies in the UK and benefit corporations in the US) that will permit the sale of shares while enshrining the social objectives of these hybrid enterprises through law. For the

[8] http://www.impactbase.org
[9] http://www.ksix.or.ke

non-profit form, bonds may be an important vehicle as well as creating private entities (e.g. holdings) that may sell shares and provide capital to non-profit organizations. Our paper will address these critical issues in the context of the evolving transactional platforms or emergent marketplaces.

Methodology

Sample. For this work, we analyze at least six emerging exchange platforms, that are meant to become marketplaces to facilitate primary transactions, secondary transactions, or both. Specifically, we will explore: Nexii, The London Social Stock Exchange, IIAX, the SVX, Mission Markets, the Kenya Social Exchange. In addition, we include a separate analysis of the Community Reinvestment Fund (CRF-US), that has successfully implemented a secondary market in the impact investment field, working as an intermediary between the community lenders and institutional investors. CRF-US may provide insights that guide developments of the field more broadly.

Sources. We use both primary and secondary sources of information to analyze our sample. Our primary sources include individual interviews with founders or executives of each platform where possible, as well as information gathered from their website and information guides, including listing requirements, investor requirements, etc. Secondary sources include academic publications and other articles from prominent journals and magazines.

Analysis. As a first step in our analysis we map and organize the information of each platform in a matrix and analyze/compare them on the following criteria: (1) location, (2) whether the platform allows primary or secondary transactions, (3) whether it is tailored to for-profit organizations or non-profit, (4) diversity of investment vehicles offered by the exchange/platform, (5) the start date, (7) internal processes, (8) implemented policies, (9) investor rights, (10) investee rights, (11) target investors, (12) financial reporting mechanisms, (13) transparency, (14) governance, (15) auditing (if any), (16) financial and social expected returns, (17) regulation and public policy (regional, national, transnational).

Secondly, with complementary information from interviews we are able to analyze and identify current barriers: (1) challenges that these initiatives are facing in light of the current state of the market, (2) mechanisms by which they are influencing the evolution of the market and (3) new opportunities for increasing liquidity and capital flows into this market.

Contribution

The need for capital continues to be identified as a key challenge, hence the need for an integrated and coherent marketplace, or for transactional platforms that includes both primary and secondary markets. The challenge we are addressing is to better understand how secondary markets can be designed given the diversity and hybridity of the enterprises involved. Examining those secondary markets that currently exist will provide important insight into how to develop these in different contexts. How to generate more liquidity, how to design exit strategies, how to develop a social capital market that corresponds with the diversity of social enterprises or social economy businesses, have been identified by our practitioner partners as key challenges. The research, thus far, confirms the need to pursue this investigation and propose a range of options that can co-exist and provide the much needed access to large-scale investment capital and address the challenges raised by practitioners. This is a marked departure from the homogeneous model of share capital and the exchanges in which trading currently occurs.

This research is contributing to the work that is ongoing in Quebec and in Canada among practitioners who are partners in this research as part of the SSHRC-CURA on Responsible Investing

Project. CURA partners represent thirty-one national and international organizations and networks of practitioners, academics and stakeholders on responsible investing. Our partners include practitioners from the investment sector, university research centers, and key stakeholders from our target audience.

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