Navigating the New World of Social Impact Investing:

An Opportunity and Challenge for Foundations

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EXECUTIVE SUMMARY

This report, *Navigating the New World of Social Impact Investing*, examines the recent philanthropic innovation of mission-related investments (MRIs) and specifically low-profit limited liability companies (L3Cs). The report characterizes L3Cs as a fresh solution that needs further investigation from the philanthropic community, and with this in mind is guided by four goals:

- Summarize the essential details of the new L3C framework;
- Examine insights offered by an initial cohort of L3C social entrepreneurs since the framework's adoption just two years ago;
- Situate the promise of L3Cs within a broader framework of mission-related or "social impact" investing; and
- Articulate how foundations possess an essential and unique role in generating greater understanding of the L3C framework, and for stimulating L3Cs as a mechanism for promoting social change.

The publication of this report is timely: no existing publication to our knowledge has examined social impact investing and L3Cs in this fashion. An explicit ambition of this report is to encourage philanthropic leaders to design and establish new dialogues and forums to explore how to translate L3C experiments into sustainable mechanisms for social change. We, therefore, push foundation leaders to look beyond descriptive questions such as "What are L3Cs?" to consider more complex questions such as "How should we design an impact investing strategy that supports our mission and values?" and "What are the organizational challenges we will encounter while experimenting with implementing an impact investing strategy?"

Key Findings

Although the report discusses numerous findings and recommendations in detail, our primary insights appear below.

- Foundations that are not actively investigating the benefits and challenges of L3Cs are missing a unique opportunity, even if their leaders ultimately conclude that L3Cs are "right" for them only as an experiment
- The nonprofit, for-profit, governmental, and philanthropic sectors should consider L3Cs as a complementary solution to traditional grantmaking, not a rival alternative
- The L3C framework has experienced modest success since its creation in 2009, yet nascent L3C business confront numerous challenges or "growing pains;" the primary short-term challenge is increasing awareness around the L3C and its potential benefits
- The experiences of L3C "pioneers" describe an instrumental and leading role

for foundations in the development and proliferation of the L3C as a mechanism for social change; these social entrepreneurs envision the success or failure of the L3C as depending on the short- and long-term actions of foundations
- Foundations possess a unique set of social, human, and financial capital resources that no other institution can match; and although L3C pioneers acknowledge a need for sustainable financial resources, they also desire the legitimacy and “stamp of approval” that accompany grants and program-related investments from foundations in order to attract additional capital from for-profit investors
- A foundation’s serious examination of developing a social impact investing strategy should address four considerations: 1) understanding organizational barriers to impact investing, 2) evaluating existing expertise with impact investing, 3) convening forums to discuss impact investing, and 4) developing partnerships for impact investing
- An earnest examination of potential organizational barriers to impact investing should be envisioned as an opportunity rather than a problem, for although foundations may typically gravitate toward the status quo (*i.e.*, traditional grantmaking), an awareness of these organizational predispositions will reveal that experimenting with social impact investing does not require a significant reprioritization of strategies or objectives
- The decision to experiment with social impact investing such as L3Cs presents new opportunities to recruit talented and fresh perspectives into the organization, further strengthening a foundation’s existing capacity to orchestrate social impact
- To best develop awareness around L3Cs, foundations can activate one of their greatest resources: their relationships with a diverse set of external stakeholders; the creation of dialogues and forums about social impact investing underscores that not only are foundations endowed with vast financial resources (even after the recession), they also posses unique and invaluable social and human capital that will prove essential in stimulating awareness and interest in social impact investing
- Foundations need not radically transform themselves, or undermine the web of relationships that comprise their traditional grantmaking, in order to assume a leading role in supporting impact investing; instead they only need to signal a commitment to advancing the kind of adaptation and experimentation long associated with American philanthropy

These key findings underscore that this report strives to investigate basic yet fundamental questions, choosing to more closely examine questions of "who" and "how" than other industry reports discussing social impact investing. Our hope is not to temper an impulse for action around stimulating social change as much as it is to direct it. With a renewed focus on integrating the best of traditional approaches and innovative solutions, foundations can continue their proud legacy of helping other stakeholders discover answers to the most vexing social problems confronting neighborhoods, communities, and institutions across the country and around the world.

INTRODUCTION: A RICH HERITAGE OF EXPERIMENTATION IN AMERICAN PHILANTHROPY

For more than a century, philanthropy in the United States has played a unique role in addressing societal challenges, differentiating itself from other Western societies and spanning two broad sets of anchoring philosophies.

Like many uniquely American institutions, philanthropy has consistently reflected traditional religious practices and a changing social contract in a new secular expression. At the same time, philanthropic practice has served as a way to bridge private, public, and nonprofit sector activities in order to solve problems that beset the whole society.

One of the most influential figures in American philanthropy, Andrew Carnegie was a staunch believer in free enterprise, a determined pragmatist, and an individual committed to social responsibility. In his iconic personal statement, "The Gospel of Wealth," written at the end of the 19th century, Carnegie admonished those who distributed their wealth without careful regard for enduring impact. He argued for investments that would stand over time and could address underlying conditions as well as the symptoms of problems.

It is in this rich tradition of experimentation and adaptation in American philanthropy that we offer this report. Social, political, and economic factors have always challenged and shaped how organized philanthropy approaches its work. This report documents the lessons and early implications of one emerging response to recent trends: the recent development of low profit limited liability companies – L3Cs – as a means of sparking change in neighborhoods, communities, and institutions.

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Low profit limited liability companies are part of a broader movement in the philanthropic sector toward investments that complement, and focus aspects of traditional grantmaking. In this respect, grant makers are introducing elements of market sensitivity, economic sustainability, and forms of competitiveness into their work – all of which have significant implications for the nonprofit sector, policy makers, and the way we conceptualize and approach solutions to societal problems.

Economic circumstances certainly drive some of this experimentation. Part stems from a subtle but clear change in the relationships among the public, private, and nonprofit sectors. Some of the impetus reflects the fact that after decades of philanthropic investment many of our most vexing societal problems are not going away; and some believe that social progress has been stymied by the sheer clutter of challenges and a collective inability to develop solutions. There is a powerful commitment to achieve results, or at least to demonstrate greater impact in the areas philanthropy identifies for investment – and there is a growing appetite to do this by considering a broader range of strategies.

"Social impact investing" is not an alternative means to achieve the ends of traditional philanthropy. It is an end *and* a means, one that has become associated with a set of strategies that are influencing the entire sector. A consensus has emerged among social entrepreneurs, philanthropic leaders, and policymakers that a commitment to impact investing is critical to finding solutions to intractable social crises such as poverty, climate change, and educational disparities. The optimism surrounding impact investing is so high — and the commitment to it is emerging — that even prolonged economic uncertainty is being characterized as a reason *for*, rather than an inhibitor of, this next stage in philanthropic experimentation. The Rockefeller

Philanthropy Advisors (2010) illustrate: "Despite the global economic volatility we have seen in the past year, and perhaps in part a result of it, interest in impact investing . . . has grown significantly" (p. 5).

Numerous reports document this trend, creating an impression of inevitability. But the initial enthusiasm for social impact investing, and L3Cs as a specialized vehicle for increasing and sustaining impact, has led to pronouncements, sometimes without much evidence to substantiate the concept. Despite optimistic rhetoric, these same reports describe an ambition that is infectious, but lacking a clear call to action.

> The initial enthusiasm for social impact investing, and L3Cs as a specialized vehicle for increasing and sustaining impact, has led to sweeping pronouncements, sometimes without much evidence to substantiate the concept. Despite soaring rhetoric, these same reports describe an ambition that is infectious, but lacking a clear call to action.

Closer examination illustrates a nascent phenomenon featuring significant challenges and uncertainty. Although the foreword of a recent report of the Rockefeller Philanthropy Advisors (2010) describes "investors" as "creatively challenging the status quo in order to address major problems," the same report's conclusion matter-of-factly states, "Historically, impact investing has suffered from overconfidence on the part of the impact investing community, but also lack of confidence from the traditional investment community" (p. 126). Without discounting the potential merits of impact investing, we are still enjoying the infatuation stage of this new phenomenon – and grasping to match passion with financial return.

The future of social impact investing, therefore, remains much more uncertain than either its recent excitement or its stage of experimentation yet validates. An often overlooked reality may be that the perceived viability of impact investing stems as much from the daunting challenge of energizing alternative solutions as from its own record for providing solutions. At the moment, stimulating impact investing requires signature successes to leave a lasting impression on decision-makers in government, business, and nonprofit sectors seeking to rebound

after the recession. The same observation holds for the viability of L3Cs. The great promise – and potential missed opportunity – of the L3C mechanism stands before stakeholders; put more directly, these stakeholders can either seize or miss their opportunity to lead a collective effort to generate greater awareness and understanding of L3Cs as a potential tool for social change. Among these stakeholders, foundations are uniquely situated to assume a leadership role.

The great promise – and potential missed opportunity – of the L3C mechanism stands before stakeholders; put more directly, these stakeholders can either seize or miss their opportunity to lead a collective effort to generate greater awareness and understanding of L3Cs as an effective tool for social change.

In this report, we examine a limited set of initial experiences with L3Cs while offering a fresh investigation of the potential benefits of this new direction in philanthropy. Although a growing body of industry reports examines the broad social impact investing landscape, only a smaller subset discusses the role of mission-related investments (MRIs), and a very small literature analyzes L3Cs. This report, therefore, has the following discrete ambitions:

1. Summarize the essential details of the new L3C framework;
2. Examine insights offered by L3C pioneers over the past two years;
3. Situate the promise of L3Cs within a broader framework of social impact investing; and
4. Articulate how foundations possess an invaluable – in fact, essential and unique – role in stimulating the development and proliferation of L3Cs as a mechanism for promoting social change.

The timing of this report is important. No existing publication, to our knowledge, integrates these facets of social impact investing, especially with a goal of informing the development of L3Cs. We hope it stimulates greater interest in developing L3Cs, and prompts philanthropic leaders to design and create new dialogues and forums to explore how to translate

excitement for L3Cs into sustainable mechanisms for social change. We encourage foundation leaders to look beyond descriptive questions such as "What are L3Cs?" to consider more complex questions:

1. "How should foundation leaders conceptualize an impact investing strategy that reflects and supports the foundation's mission and values?" and
2. "What are the organizational challenges foundations will encounter when developing and implementing an impact investing strategy?"

We encourage foundation leaders to look beyond descriptive questions such as "What are L3Cs?" to consider more complex questions: "How should foundation leaders conceptualize an impact investing strategy that reflects and supports the foundation's mission and values?" and "What are the organizational challenges foundations will encounter when developing and implementing an impact investing strategy?"

In this report, we contend that foundations and their stakeholders can realize the potential of impact investing and L3Cs only if they approach the opportunities as an extended experimental strategy. By describing L3Cs as "experimental" we mean that they appear to have promise as a mechanism for philanthropic investment and their success should be judged through careful and systematic evaluation over the long term and under varied conditions. Therefore, we advocate for a longer strategic horizon. In essence, our conclusions liken philanthropic support of L3C businesses to providing pre-seed capital for entrepreneurial start-up businesses.

Our findings indicate that there is much to learn about the use of L3Cs. Foundations and their leaders should pursue experimental mechanisms while carefully documenting, evaluating, and learning from these new experiences. The experimental process – one with a rich heritage in American philanthropy – presents vexing questions. Among those questions is the effect that L3Cs have on funders and their partnering agents (financially, legally, and organizationally); and whether L3Cs could further generate significant improvements in the underlying social conditions that are the shared concern – and responsibility – of philanthropy, nonprofit organizations, policy makers and the public.

The Policy Foundation for L3Cs: Program-Related Investments

Although L3Cs represent the latest innovation in American philanthropy, their legal genesis can be traced to the Tax Reform Act of 1969, which established program-related investments (PRIs). Through PRIs, Congress hoped that foundations would begin investing directly in organizations benefiting society and reflecting the social missions of foundations.

A critical component of a PRI is that it does not threaten a foundation's exempt status. PRIs count toward the five-percent qualifying distribution requirement – the rule requiring foundations to spend at least five percent of the average market value of their previous year's assets each year on charitable purposes (Rockefeller Philanthropy Advisors, 2010, p. 2). A program-related investment can assume the form of a loan, an equity position, a loan guarantee, or any other transaction in which the foundation has an economic interest, as long as it has the following characteristics:

1. Its primary purpose is the accomplishment of a charitable purpose that is enumerated in IRC § 170(c)(2)(B);
2. Neither the income generation nor property appreciation is a significant purpose of the investment; and
3. It does not assume a prohibited political character such as supporting the lobbying legislation or the campaigning of political candidates (Maslow & White, 2010).

The program-related investment, therefore, created a new investment alternative for foundations: investing in for-profit ventures, albeit at below-market returns, without jeopardizing their tax-exempt status. Over the past decade, social entrepreneurs and philanthropic leaders have generated renewed interest in PRIs by pursuing mission-related investments (MRIs). MRIs are considered "any investment activity which seeks to generate a positive social or environmental impact in addition to providing a financial return" (Rockefeller Philanthropy Advisors, 2008, p. 11). Whereas PRIs are below market rate investments, MRIs describe market rate investments.

Since the late-1980's, impact investing strategies such as mission-related investing have attracted attention from the philanthropic community. Paul Ylvisaker, a longtime program executive at the Ford Foundation and former dean at Harvard University, is credited with helping to stimulate interest in mission-related investing with his 1989 essay for the Council on Foundations entitled "Small Can Be Effective." In this piece, he asserted that foundations serve an essential and unique role in American society, likening their effect to "society's passing gear": the vast financial, social, and human resources of foundations should be directed not only at traditional grantmaking but also to refining innovative approaches to social problems (Rockefeller, 2008, p. 8-9). Over the past three decades, a broader set of organizations – governmental agencies, nonprofit organizations, and even many foundations – have embraced this notion that market-driven methods, albeit far from a panacea, generally inspire fresh solutions to vexing challenges.

The increased acceptance of mission-related investing illustrates that longtime dichotomies and silos between "financial" and "impact" are less pronounced than they were just a decade ago.

Figure 1: Comparing "Financial First" and "Impact First" Investors (Adapted from Monitor 2006; 2010)

In the words of one foundation official "There is an idea that values are divided between the financial and the societal, but this is a fundamentally wrong way to view how we create value . . . The world is not divided into corporate bad guys and social heroes" (Rockefeller, 2008, p. 13). The advent of mission-related investing, therefore, illustrates a trend toward foundations steadily rejecting outdated "two pocket" models of philanthropy – or when financial resources are managed in isolation from solutions-focused grantmaking – in favor of an integrated, holistic strategy whereby improving lives and improving bottom lines become one and the same.

A common example of an MRI is a market-rate insured deposit in a credit union or community development bank serving a low-income market (F.B. Heron Foundation, 2010). Importantly, MRIs satisfy the IRS's program-related investment conditions; it is also important to note the IRS elaborates its conditions by

underlining that "If an investment incidentally produces significant income or capital appreciation, this is not, in the absence of other factors, conclusive evidence that a significant purpose is the production of income or appreciation of property" (Internal Revenue Service, 2010). Mission-related investments reflect the same mission-based character of PRIs, but with greater attention to generating market-rate returns, often with the ambition of creating sustainable frameworks for incorporating financial resources into socially beneficial projects.

Figure 1 (p. 11) depicts the relationship between program-related investments and mission-related investments and describes two types of investors.

A "Financial First" investor seeks to optimize financial returns over social impact; this group consists of commercial investors in search of market-rate returns that yield some social good (Monitor, 2009). In contrast, an "Impact First" investor optimizes social returns over financial gain; this group consists of a more amorphous set of investors willing to accept lower-than-market returns in order to maximize social impact (Monitor, 2009). Within the context of this report, program-related investing and (most) mission-related investing falls into the "impact first" category. In other words, instead of solely writing grants to nonprofit organizations, foundations may choose to pursue the social objectives of their foundations by making investments, albeit constricted, in for-profit ventures.

Although the PRI framework has existed for four decades, few foundations use program-related investments to advance their social missions. Not even 200 of the more than *72,000* foundations in the United States made PRIs in 2006; these investments totaled $365 million, accounting for *less than one percent* of the total qualifying distributions made by

foundations in 2006 (FSG Social Impact Advisors, 2007). The concentration of PRI activity is even more dramatic than these figures suggest with four prominent foundations – the Ford Foundation, the David and Lucile Packard Foundation, the John D. and Catherine T. MacArthur Foundation, and a large anonymous foundation – accounting for the vast majority of PRI investments in economic development, education, the environment, and housing (FSG Social Impact Advisors, 2007).

Several reasons help explain the dearth of PRIs. First, foundations may not possess expertise, or even an interest, in making impact investments (Equilibrium Capital Group, 2008). Second, foundations often seek legal reassurances that impact investments actually qualify as PRIs due to fears of paying significant excise taxes if they make an incorrect determination (Coren and Lang, 2009-2010). Foundations, therefore, may dismiss PRI opportunities, if only to forgo the need to seek private letter rulings from the IRS or opinion letters from attorneys before investing in a PRI, or to conduct expensive and time-consuming due diligence processes.

L3Cs: The Future of Mission-Related Investing?

In recent years, a new legal mechanism has reinvigorated program-related investments: the low profit limited liability companies. The impetus for the L3C reflected a belief that the PRI, an underutilized mechanism among foundations, could be better leveraged to help capitalize social enterprises. The architects of the L3C framework assert that foundations will increasingly use PRIs if there was a legal entity meeting the PRI requirements; the L3C framework would hopefully provide foundations the same signal that the 501(c)(3) designation provides them with respect to grantmaking.

In essence, L3Cs represent a legal extension of the limited liability company (LLC). Maslow and White (2010) provide a

succinct, but comprehensive definition of an L3C:

> As a form of limited liability company (LLC), the L3C offers the personal liability protection of a corporation, and the flexibility of a partnership. Like a 501(c)(3) nonprofit, the L3C is designed to advance a socially beneficial purpose; unlike the 501(c)(3), the L3C allows for traditional equity investment, and sales of those investment stakes (Maslow & White, 2010, p. 63-64).

In other words, the L3C is a "hybrid of a hybrid entity" (Maslow & White, 2010). The L3C offers the best of both worlds for social entrepreneurs and social investors: its flexibility and protection, its (potential) designation as a PRI, its distinct social orientation, and its focus on sustainable market returns. Robert Lang, creator of the L3C and CEO of the Mary Elizabeth and

THE PROMISE OF L3CS: A NASCENT EXAMPLE IN MICHIGAN

The spirit motivating a low-profit limited liability company (L3C) originates across the public-private spectrum and runs through the nonprofit sector. The Council of Michigan Foundations (CMF) clarifies L3Cs versatility by offering one specific example – an affordable housing project.

Five key participants in the initiative include:

- A for-profit real estate developer
- A nonprofit community development corporation "sponsoring" the project
- A bank fulfilling its Community Reinvestment Act requirements
- The Local Initiative Support Corporation (LISC) providing a loan to the project
- A county or other local government agency making a grant to the project

The establishment of an L3C enables each sector to invest its resources and apply them to a shared initiative like community development. Its broad appeal to investors – foundations and profit-oriented individuals or organizations alike – is a distinguishing characteristic of L3Cs.

The Local Initiative Support Corporation provides one prominent proxy with over 30 years of work in communities across the country. LISC, which was originally organized by the Ford Foundation, currently offers grant, loan, and equity financing for its new Strategic Plan – Building Sustainable Communities – seeking to "create neighborhoods that are good places to live, do business, work, and raise families"(LISC, n.d., p. 1). L3Cs match the complexity of building communities in the 21st century with an accessible investment space to pool resources across sectors.

Gordon B. Mannweiler Foundation, has referred to the L3C as "the for profit with the nonprofit soul" (Coren & Lang, 2010). The L3C facilitates tranched investing through program-related investments; foundations, issuing the PRIs, assume the highest level of risks, thereby minimizing the level of risk for private investors in lower tranches (InterSector Partners, 2010). Lang (2010) further explains, "Because foundations take the highest risk at little or no return, it essentially turns the venture capital model on its head." Through PRIs and L3Cs, foundations assume a role traditionally held by venture capitalists: catalyzing investments in early-stage entrepreneurial businesses. The two call-outs provided in this section elaborate on this concept of foundations as initial investors through specific examples and initiatives.

Due to this flexibility and other potential benefits, L3Cs have generated considerable "buzz." As of July 17, 2010, L3C legislation has been introduced in twenty states. Seven states – Michigan, Illinois, Maine, North Carolina, Utah, Vermont, and Wyoming, as well as two Indian nations, the Ogala Sioux Tribe of Montana and the Crow Indian Nation – have passed the legislation, and the legislation has been enacted into law in all but two of those states, Maine and North Carolina (InterSector Partners, 2011). As of January 2011, 303 companies were registered as L3Cs across the United States, including more than 70 in Michigan (InterSector Partners, 2011).

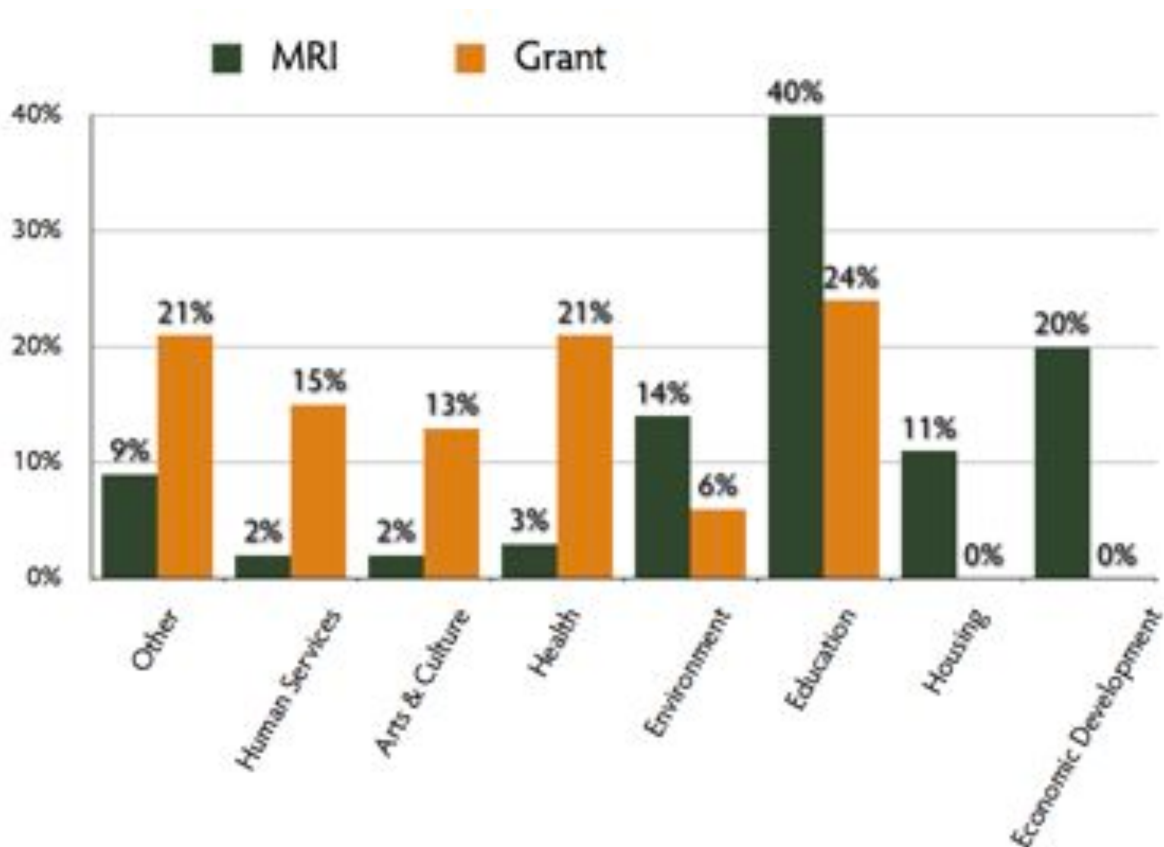
L3C proponents have also drafted federal legislation in hopes of stimulating more L3C businesses. The Philanthropic Facilitation Act of 2010 would amend §4944(c) of the Internal Revenue Code to provide a rebuttable presumption that investments in L3Cs qualify as PRIs. The legislation and accompanying regulations would establish a voluntary procedure, similar to that now in existence for recognition of a 501(c)(3) tax-exempt organization, allowing entities to receive an IRS determination

that an investment in a specific company qualifies as a PRI for any private foundation with a common purpose. As of July 15, 2010, this legislation had been drafted but not yet introduced in Congress (Schmidt, 2010).

Comparing Grantmaking & Social Impact Investing

Any list of common social challenges – developing alternative energy sources, addressing global climate change, or improving underperforming schools and educational systems – feature problems requiring complex and systemic solutions. Industry observers such as the Rockefeller Philanthropy Advisors and the Meyer Memorial Trust argue that traditional philanthropic grantmaking offers incomplete solutions to these challenges.

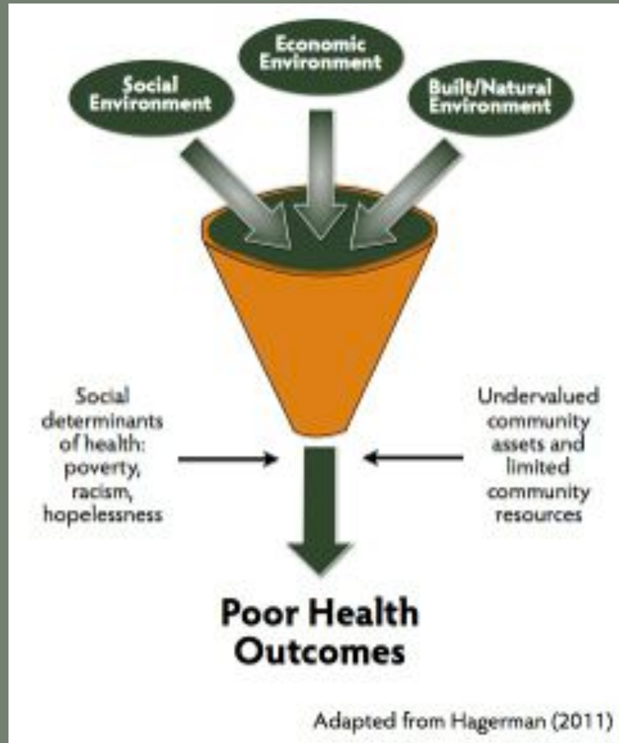
Figure 2: Foundation Philanthropic Investments, by Category and Type



THE FRESH FOOD FINANCING INITIATIVE

The Food Trust prompted the Fresh Food Financing Initiative based on a dire social situation -the number of Philadelphia supermarkets ranked second lowest in the nation on a per capita basis relative to other major cities. Specifically low-income neighborhoods suffered negative health effects due in part to limited food access. With a mission to ensure everyone has access to affordable and nutritious food, the Food Trust - founded as a nonprofit in 1992 - collaborated with the Commonwealth of Pennsylvania and The Reinvestment Fund (TRF) - a community investment organization - to establish the Fresh Food Financing Initiative (FFFI). The $120 million program received an initial five-year $30 million grant from the state along with a 3:1 TRF state-dollar match to catalyze private capital investment. The FFFIs recent progress highlighted below suggests the initiative as a possible MRI engagement framework for other states and metropolitan areas.

- 93 of the 206 total applicants have been approved for FFFI funding
- Over $73.2 million in loans and $12.1 million in grants have been approved
- Recipients are expected to generate 5,023 jobs and 1.67 million square feet of commercial space



Lisa Hagerman, Director of More for Mission Campaign Resource Center at Harvard University, presented at the Social Investment Forum & Community Capital Management Community Investing Conference in February, 2011 and provided a model of the California Healthy Food Financing Initiative which based its public-private partnership loan fund on the FFFI framework and offers a contextual model identifying key factors related to sustaining community access to healthy food.

The California Endowment model attempts to build on the issue of access to healthy food established by the FFFI by intentionally promoting economic development and innovation through their support of healthy food retailing and distribution operations. As the California approach suggests, using a continuum of investment vehicles to address the food emergency offers a potentially more comprehensive solution to an acute problem. This brief history of promoting access to healthy food illustrates mission-related investing's critical junctures to include identifying an investment opportunity, forging a cross-sector collaboration, and ultimately producing quantifiable results. The FFFI information provided above is available in further detail at http://www.thefoodtrust.org/php/programs/fffi.php. Information on the California Healthy Food Financing Initiative is available on the More for Mission Resources page at http://www.moreformission.org/page/2/resources.

This belief leads some observers to identify PRIs and L3Cs as promising complements to conventional grantmaking.
Social impact investing, in its various forms, differs from traditional grantmaking in important ways. Not only do traditional grantmaking and impact investing such as program-related investments feature different underlying legal frameworks, they (to date) tend to be applied to different types of social challenges. FSG Social Impact Advisors explores these differences by comparing impact investing and traditional grantmaking by category (see Figure 2 on p. 16). While education, economic development, and housing projects gravitate toward some version of impact investing, health, human services, and arts projects tend to receive funding in the form of traditional philanthropic grants.

But more importantly, the role of financial resources, and accompanying cultural implications for foundations, helps to explain the differences between impact investing and grantmaking. Rockefeller Philanthropy Advisors (2008), for example, explores the conceptual distinction between grant-making and investments within foundations: the foundation's "core activity is grant-making to nonprofits while investment remains a financially-driven staff function supported by external investment managers" (p. 43). Foundation staff rarely conceptualize grants as investments; grants, driven by values, both reflect and reinforce a foundation's mission and programmatic agenda, while also satisfying their payout requirement. Foundations typically bifurcate spending and investing: socially motivated grantmaking on one hand, and financially motivated investing of the endowment on the other. This institutionalized distinction might prevent foundations from embracing impact investing. As discussed in the next section, pioneering L3C entrepreneurs characterize both traditional grants and impact investments from foundations as essential to the development and proliferation of L3C businesses across the United States.

Potential Pitfalls for L3C Adoption & Proliferation

Despite the optimism surrounding L3Cs, there are many unanswered questions about the mechanism's future role in philanthropy. The global macroeconomic climate remains an obvious concern. Financial institutions and foundations are only several years removed from experiencing unprecedented losses in wealth. In 2008, for example, foundation assets declined by 22 percent, representing a $150 billion loss of philanthropic resources (Institute for Philanthropy, 2009). Due to declining assets, many foundations have altered their grantmaking: 67 percent of foundations expected to cut grant budgets while 11 percent of foundations hoped to maintain current budgets (Foundation Center, 2009). In addition, some foundations such as the Ford Foundation have chosen to close offices and cut staff in hopes of reserving dwindling resources for grantmaking (Institute for Philanthropy, 2009).

Notwithstanding recent optimism about economic turnaround, a lingering sense of financial insecurity among foundations could stymie interest in social impact investing, and especially investments in L3C businesses, for several reasons. First, foundations may choose to prioritize their existing grant portfolios and relationships with nonprofit leaders. Second, decreasing grantmaking budgets, as well as cutting staff resources, signals an implicit continuation of conventional grantmaking practices – as the status quo – until macroeconomic conditions improve. In both cases, the prudent reaction of foundations to the recession might undermine previous momentum in experimenting with new types of social impact investing such as L3Cs. Moreover, there may be some

concern that L3C businesses could, in time, compete with existing grantmaking to nonprofits. One Colorado-based social entrepreneur, for example, states that "Nonprofits are feeling threatened by this [the emergence of L3Cs] because they think it's going to draw foundation money away from them" (InterSector Partners, 2010, p. 20).

Although continued financial uncertainty affects the proliferation of L3C businesses, other factors probably constitute more significantly to their uncertainty. First, some social entrepreneurs, private investors, and attorneys question the premise of L3Cs as an alternative to existing forms such as LLCs or nonprofits (501(c)(3)s). Although some social entrepreneurs are beginning to gravitate to the L3Cs explicit social mission – one Chicago-based L3C entrepreneur explains that "we want to make sure after all these years our enterprise doesn't turn into another business enterprise" – other social entrepreneurs, attorneys, and private investors question the necessity of the L3C framework (InterSector Partners, 2010, p. 9). "Many L3C entrepreneurs … hear the argument that the L3C is unnecessary because it is so similar to an LLC; that . . . the things they plan to do with an L3C they could have done with an LLC" (InterSector Partners, 2010, p. 10).

Second, the lack of common, understood metrics constitutes another challenge stymieing the proliferation of L3C businesses. Some L3C entrepreneurs "worry that the L3C may be falsely labeled as a watered-down or phony nonprofit," underscoring the need for social and financial metrics (InterSector Partners, 2010, p. 16). A conventional LLC-based business might measure value in terms of revenues and profits and a nonprofit might measure outcomes in terms of individuals receiving service – but what hybrid portfolio of metrics captures the mission of L3Cs? One Denver-based L3C entrepreneur explains: "The lack of definition and the lack of accountability … right now is

Some L3C entrepreneurs "worry that the L3C may be falsely labeled as a watered-down or phony nonprofit," which only underscores the need for social and financial metrics (InterSector Partners, 2010, p. 16).

perhaps the greatest weakness of the entire movement" (InterSector Partners, 2010, p. 16).

Similarly, some social entrepreneurs fear that the "low profit" moniker of L3Cs might undermine interest from private investors. A Denver-based L3C entrepreneur, for example, fears that " . . . when we think of low profits, it's like 'Sorry, I don't even want to go there.' Business is hard enough without feeling you have that kind of limited range" (InterSector Partners, 2010, p. 16). A similar sentiment is offered by a Massachusetts-based social entrepreneur who claims "to me, low profit means low impact. And I don't want to have low impact . . . I've never been comfortable with low-profit in the L3C name because who wants to invest in a low-profit company?" (InterSector Partners, 2010, p. 17). Although social entrepreneurs welcome the mission-focused nature of the L3C framework, they also acknowledge that its explicit emphasis on mission over profit might complicate their efforts to attract attention from private investors.

A similar sentiment is offered by a Massachusetts-based social entrepreneur who claims "to me, low profit means low impact. And I don't want to have low impact … I've never been comfortable with low-profit in the L3C name because who wants to invest in a low-profit company?" (InterSector Partners, 2010, p. 17).

The most significant factor that may stymie interest in L3C businesses, however, is a lack of awareness among social entrepreneurs, philanthropic leaders, and private investors. The L3C is an idea in its infancy – it did not exist in legal terms until 2008 – and social entrepreneurs have learned about the new mechanism through disparate communication channels such as conferences (such as the Social Enterprise Alliance), Web pages (such as Robert Lang's Americans for Community Development) and word-of-mouth (InterSector Partners, 2010). This lack of awareness not only impedes broad interest among social entrepreneurs in the potential power of L3Cs, but also means that L3C entrepreneurs encounter difficulties seeking legal and accounting advice when establishing businesses. According to Marty Campbell of Foundation Source, the legal ambiguity of L3Cs also inhibits serious consideration from investors and

foundations. With respect to foundations, for example, "The primary stated benefit of an L3C . . . is that it helps to qualify investments for a PRI but that has not panned out . . . The charitable purpose of the L3C . . . remains a source of ambiguity in IRS regulations for PRIs" (InterSector Partners, 2010, p. 13).

Due to the novelty of the L3C framework, most L3C entrepreneurs remain in the planning stage. One report indicates that most L3C entrepreneurs continue to explore the implications of the L3C framework for organizing and funding their businesses (InterSector Partners, 2010). Other L3C entrepreneurs have begun funding nascent operations like most entrepreneurs: piecing together personal savings, modest private loans, and revenues from products or services (InterSector Partners, 2010). To establish sustainable enterprises, or at least those generating some semblance of profit, social entrepreneurs believe that L3Cs will need to integrate a variety of funding sources from numerous sectors.

L3C Pioneers Envision A Leading Role for Foundations

Although L3C entrepreneurs are pursuing funding from a variety of sources, many of these social innovators specifically desire funding from foundations. InterSector Partners (2010) reports that numerous L3C entrepreneurs believe that their nascent enterprises would not acquire sufficient resources if they only targeted one funding source, whether it is pre-seed and seed capital from private investors or grants from foundations. L3C entrepreneurs might prioritize establishing relationships with foundations over other types of investors for several reasons. First, the explicit social mission of L3Cs might appeal more to foundations than private investors, especially in the earliest stages of development. InterSector Partners (2010) reports that many of its L3C clients believe "that if they can pitch their business to a likeminded foundation, whose mission

is focused in the field in which their business operates, they can obtain a program-related investment from the foundation" (p. 12).

In courting "likeminded" foundations, some L3C entrepreneurs prefer establishing relationships with local foundations instead of more prominent national foundations that have more financial resources. Christopher Washington, a L3C entrepreneur in Washington, DC, believes that local foundations are simply easier to engage. "We were talking more with bigger national foundations, but we're changing that strategy. This year, we're . . . focusing more local, there is less bureaucracy" (InterSector Partners, 2010, p. 13). Brendan McCrann, a Denver-based social entrepreneur, argues that smaller family foundations are more open to learning how to co-construct an approach to funding L3C businesses. "If we can become insiders and be part of discussions with boards . . . we can sell this . . . the reward will outweigh the risk. At that smaller level, in my mind, is where PRIs are going to first appear" (InterSector Partners, 2010, p. 13).

Despite burgeoning interest among a dedicated minority, foundation leaders admit that foundations could do much more to promote L3C businesses. Marty Campbell of Foundation Source, which serves over 900 foundation clients across the United States, characterizes most foundations as having a limited understanding of L3Cs. "Several of our clients are very interested in social enterprise, PRIs, and equity investments, but few have actually taken action to utilize these other tools and fund social enterprises" (InterSector Partners, 2010, p. 13). Marc Lane, a prominent attorney with L3C experience, also believes that awareness of L3Cs remains low among foundations, especially among small foundations (InterSector Partners, 2010). Many social entrepreneurs lament this lack of awareness. One L3C entrepreneur quipped, "Nobody knows what the hell it is"

(InterSector Partners, 2010, p. 14). In response, some social entrepreneurs find themselves assuming roles as L3C "evangelists" by speaking at workshops and conferences to espouse the potential power of the new mechanism.

Despite these obstacles – perhaps more fairly characterized as growing pains than critiques – foundations have begun providing financial support to L3C businesses. InterSector Partners (2010), for example, reveals that several L3C entrepreneurs have received funds from foundations – one funder was a community foundation in one of the country's largest cities and the other was the country's largest foundation. These initial investments, however, were distributed as *conventional grants* rather than program-related investments.

Some social entrepreneurs envision foundation support as inextricably linked to the future fortunes of L3Cs. InterSector Partners (2010) speculates that social entrepreneurs anxiously await "truly public and overt" endorsements of L3Cs from prominent national and local foundations. Christopher Washington, an L3C entrepreneur in Washington, DC, believes that "the L3C will either win or lose . . . on the floor of foundations" (InterSector Partners, 2010, p. 20). One Atlanta-based social entrepreneur believes that L3Cs will generate only casual interest until foundations begin examining the finer details of the L3C framework. "It's going to take grant-makers stepping up and taking the time to understand what the structure is, what they can get out [of] it, and how it can support their mission" (InterSector Partners, 2010, p. 20). Other social entrepreneurs reiterate the looming challenge of integrating for-profit and nonprofit funding streams. One Oregon-based L3C entrepreneur explains that fellow social entrepreneurs "want this nimbleness, they want this social enterprise, they want to do this business, but how are they going to keep it alive? . . . just getting program-related

Christopher Washington, an L3C entrepreneur in Washington, DC, believes that "the L3C will either win or lose . . . on the floor of foundations" (InterSector Partners, 2010, p. 20).

investments doesn't necessarily mean it's going to be sustainable" (InterSector Partners, 2010, p. 18).

There are some observers, however, who are less emphatic about the essential role of foundations in stimulating L3C businesses. Two L3C legal experts, for example, qualify the role of foundations by stating "there is no requirement that L3Cs

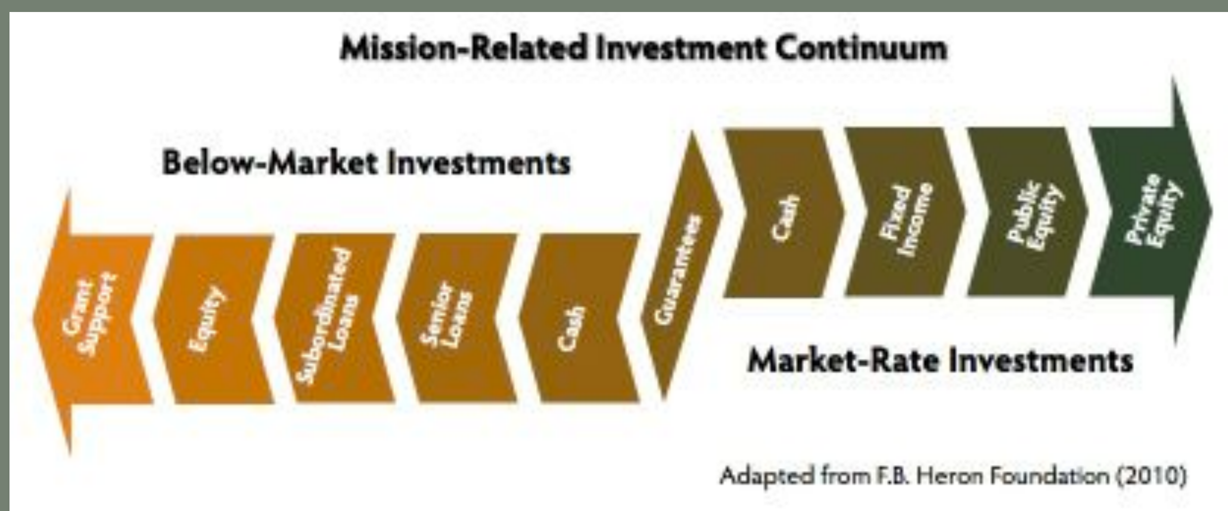
THE MORE FOR MISSION CAMPAIGN: EXPANDING THE FIELD

The More for Mission's Campaign for Mission Investing gained momentum with their first national conference held in September, 2010. Foundation leaders from The Annie E. Casey Foundation, the F.B. Heron Foundation, and the Meyer Memorial Trust launched the campaign in 2007 with a goal to generate $10 billion of new mission investments by 2012. Relying on mission-related investing experience dating back to the late 1990s, More for Mission organizers attracted 78 foundations with assets totaling over $17 billion to discuss the key barriers to mission-related investing across a spectrum of investment types depicted as a continuum of below-market rate and market-rate investments developed by the F.B. Heron Foundation and presented by More for Mission at http://www.moreformission.org/page/1/mi-strategy.

The More for Mission campaign identifies the following barriers to further developing mission-related investments:

- Delivering returns
- Utilizing relationships with consultants
- Building internal capacity
- Implementing innovative mission investment vehicles

Applying the More for Mission's national conversation to various regional economies and issues advances the exploration of mission-related investing past concept development and toward program implementation, evaluation, and financial sustainability. More for Mission national conference resources are available at http://www.moreformission.org/page/49/national-conference-september-2010-at-harvard-kennedy-school.



have foundations involved. In fact, most L3Cs are likely to be without such involvement…Consequently, critiques of the L3Cs premised on foundation involvement understate the form and its potential and, in doing so, cause unnecessary confusion" (Owens & Tyler, 2009).

Yet this effort to temper "unnecessary confusion" by separating L3Cs and foundations might prove premature, if not naïve. The voices of L3C entrepreneurs clearly illustrate that the philanthropic sector's for-profit counterparts, including venture capitalists and investment bankers, need an organizing force to focus their collective attention and minimize the risk of L3C investments. The "More for Mission: The Campaign for Mission Investing" provides an example. Started in April 2007 by the Annie E. Casey Foundation, the F.B. Heron Foundation, and the Meyer Memorial Trust, the campaign (as of November 2010) includes 87 foundations and represents $31 billion in total assets with a goal to generate $10 billion of new mission investments by 2015 (More for Mission, 2010). The capital needs of burgeoning mission-related investing ventures, including infant L3C businesses, indicate a critical role for foundations even if there is not a "required" role outlined for foundations in the L3C legal framework.

BUILDING THE SHIP WHILE SAILING: HOW FOUNDATIONS CAN STIMULATE L3C BUSINESSES

The initial experiences of pioneering L3C entrepreneurs indicate that foundations possess a unique opportunity to stimulate the development of L3C businesses as effective tools for affecting social change. These social entrepreneurs envision a leading, visionary role for foundations – both through grantmaking and program-related investments to L3C businesses – likening the role of foundations to pre-seed capital in venture capital. Without initial infusions of financial support, and a reputational stamp-of-approval, L3C entrepreneurs admit that their long-term success may prove difficult.

Although foundations continually search for opportunities to extend their impact, the opportunity to stimulate L3C businesses poses new types of challenges. For foundations to seriously evaluate new impact investing opportunities, they will need to initiate a process of self-evaluation to learn about impact investing, evaluate existing levels of their expertise and understanding, and engage in new types of partnerships with external stakeholders. The following section explores how foundations might confront these challenges – and determine the role they want to assume in stimulating L3C businesses as a form of philanthropic experimentation.

Figure 3: Examining How Foundations Can Stimulate L3C Businesses

#1: Understanding Organizational Barriers to Impact Investing

An essential discussion among philanthropic leaders is to ascertain what role social impact investing should assume in foundation activities. Philanthropic leaders may espouse the virtues of social impact investing without committing the human and financial resources, not to mention reputations, of their foundations; the stories of L3C pioneers confirm this likelihood. The reticence of some foundation leaders may not reflect a lack of will as much as prudence in initiating and leading organizational dialogues that signal shifts in how foundations allocate their financial, human, and social resources.

Yet the decision to embrace social impact investing is not merely a question of whether foundations have the "will" to change. The organizational cultures of foundations and the politics of grantmaking affect what role foundations can assume in developing L3C businesses.

Rockefeller Philanthropy Advisors (2010) and the Monitor Institute (2010) offer rich characterizations of organizational behavior within foundations. Rockefeller Philanthropy Advisors (2010), for example, evaluates foundation investments through the lens of behavioral finance, illustrating the cognitive limits of individuals and their tendency to "satisfice" rather than optimize decisions. A foundation's traditional bias toward grantmaking reflects behavioral finance's emphasis on conservatism, anchored present-day thinking, mental accounting separating social and financial impact, and loss aversion. The psychology of foundations, and accompanying cultural norms, might impede the ability of foundations to experiment with impact investing in earnest (Rockefeller Philanthropy Advisors, 2010, p. 71).

A well-intentioned conservative bias may also stymie experimentation with innovative approaches to affecting social change. Research highlights how the relationship between foundation executives and trustees perpetuate conservative resource allocation decisions. A conservative bias engenders risk aversion prompting foundations to spread their resources across many small grants (Monitor, 2010, p. 4). Harvard's (2010) Meyer Memorial Trust (MMT) case study, for example, explains the elaborate exercises foundation CEOs lead their board members through to nudge them into action. Doug Stamm, MMT's CEO, distributed a mock headline and news story to board members in order to illustrate his rationale for shifting MMT's investment policy; it took the board's shock and "Oh my God" realization for them to acknowledge and appreciate the need to adopt more mission-related approaches.

These realities of organizational behavior within foundations reinforce and entrench linear conceptualizations of social change. The Monitor Institute (2010) describes these repercussions as potential "barriers to change" (p. 4). Monitor's list of barriers reads like a list of behavioral finance's key observations. Monitor (2010) asserts that foundations should acknowledge a diverse set of challenges to change: independence and control, insularity, caution and risk aversion, a lack of time and inertia, and ultimately competition and credit-claiming with other foundations (p. 4-5). The collective effect of these challenges is that foundations further institutionalize linear decision-making processes: "identifying a problem, formulating a theory, deciding on a solution, and executing a plan" (Monitor, 2010, p. 20).

These potential barriers to change intersect a critical lifeline of philanthropic work: relationships with external stakeholders, especially grantees. Monitor (2010) characterizes foundations as insular organizations more focused on "pleasing a donor or a

board rather than [focusing] on the real-world impact of the organization and its work" (p. 4). In this depiction, foundations prioritize maintaining their web of relationships over whether grants actually affect social change. The conventional approach of foundations might create optimal decisions for grantmaking – but it might not help foundations unlock the power of impact investing or seize their opportunity to stimulate interest in L3C businesses.

Despite the saliency of these organizational barriers, current reports on impact investing devote little attention to exploring how foundations can overcome these durable barriers to change. A recent Rockefeller Philanthropy Advisors report illustrates the tendency to discount organizational barriers to change. The introduction to a chapter titled "Generating Deal Flow" states:

> Once you have defined your impact themes, developed your impact investment policy and an appropriate asset allocation, the challenge shifts to finding and executing impact investment transactions. Your success will depend on your search efforts, your advisors, the ability to tap resources and the ability to build a network of relationships (Rockefeller Philanthropy Advisors, 2010, p. 79).

This recommendation is true, but it is not entirely helpful. Although generating deal flow represents an important step in stimulating impact investing, numerous other challenges precede it – and these challenges cannot be addressed as matter-of-factly as this recommendation implies. The immediate pull of developing impact investing deals such as investing in L3C businesses cannot obscure that many foundations will need to change their practices in order to embrace impact investing. If foundations are to assume a leading, visionary role in stimulating L3C businesses as a

meaningful philanthropic innovation, they will need to consider these opportunities in their unique organizational realities.

#2: Evaluating Existing Expertise with Impact Investing

An obvious, if difficult, exercise for foundations hoping to engage in social impact investing is evaluating whether they possess the knowledge and skills necessary to experiment with these new forms of investments. Over the past generation, American organizations have observed a dramatic shift in required work competencies to compete in global marketplaces; nonprofit organizations such as foundations have encountered similar shifts, albeit in less dramatic ways, in order to meet new efficiency and accountability expectations and requirements. For foundations and corporations alike, the nature of technical knowledge has become more dynamic while "soft skills" such as communication and leadership skills have assumed greater importance.

As foundations contemplate future investments in impact investing, they will need to revisit the collective competencies of key foundation staff. Program officers, for example, will require a more complex understanding of finance in order to evaluate impact investing opportunities. In addition to refined financial acumen, foundation staff may need to demonstrate different leadership and communication skills in order to assume visionary roles in closing deals among social entrepreneurs, foundations, community leaders, and private investors.

Internal dialogues of emerging skill-sets may reveal a need to inject foundations with new talent possessing different perspectives and expertise. A promising pipeline of human capital can be found in the country's leading professional schools, especially in law, business, and public policy. Current professionals responding to the ever-louder call for integrating

social and financial impact are laying the groundwork for a new generation of social entrepreneurs. These skilled young professionals blend strong analytical and leadership skills with a genuine and steadfast ethos of improving the public good. The Monitor Institute (2010) speculates that this new generation of social entrepreneurs are not only committed to proliferating impact investing, but envision a new "social contract" among governments, businesses, and other nonprofits such as foundations (p. 40). Foundations should be advertising "Help

SOCIAL VENTURE FUND: ROSS SCHOOL OF BUSINESS AT THE UNIVERSITY OF MICHIGAN

An important pipeline for dedicated and knowledgeable social impact investing talent are social entrepreneurship funds at leading business schools. The Social Venture Fund (SvF) at the Stephen M. Ross School of Business at the University of Michigan, for example, seeks to generate interest in impact investment through its mission to:

> Transform the way business is done by educating the next generation of socially-minded business leaders to invest in and manage innovative, profitable, and sustainable businesses.

In 2009, four Ross MBA students launched the SvF, laying the groundwork for future students to understand the intersections of private investment, social problems, and the public good. As Gautam Kaul, SvFs faculty advisor and the John C. and Sally S. Morley Professor of Finance, reflects, "The business world needs intelligent leaders who can do good for society in a financially disciplined and rewarding way" (Nickson, 2010, p. 1).

SvF students balance financial and social returns by investing in five modest portfolios: Education, Environment, Finance, Food & Nutrition, Health and Urban Revitalization. Just as these areas represent opportunities for societal impact, the SvF recognizes the strategic importance of financial, human, and social capital needs. By organizing the activities listed below, the SvF implements a successful social impact initiative.

- *Financial capital*: fund-raising efforts to facilitate investments of up to $200,000
- *Human capital*: 20 business students gain hands-on experience managing a fund, developing investment strategies, and conducting due diligence through the SvF
- *Social capital*: SvF students build their collective knowledge base with the help of faculty, board members, social entrepreneurs, and other business professionals

More information on the Social Venture Fund is available from the Samuel Zell & Robert H. Lurie Institute for Entrepreneurial Studies at http://www.zli.bus.umich.edu/wvf/svf_overview.asp.

Wanted" signs for these "thinkers and doers" that could complement the perspectives and skills of existing staff. One set of groups focusing the talents of emerging social entrepreneurs is social entrepreneurship and venture funds at leading business schools across the United States. One group, the Social Venture Fund at the University of Michigan's Ross School of Business, is featured in the callout box on p. 32.

#3: Convening Forums to Discuss Impact Investing

For those foundation leaders wanting to pursue impact investing, initial steps should include understanding potential organizational barriers to change and existing levels of expertise. After reaching some level of confidence with these considerations, foundation leaders can then turn their attention to activating one of their most critical resources: relationships with external stakeholders. If foundation leaders are poised to organize collaboration in support of mission-related investing, an important step would be to sponsor and host forums among diverse stakeholders to discuss the challenges of impact investing.

These roundtable forums serve numerous complementary purposes. For starters, the forums ascertain the extent to which stakeholders understand social impact investing and appreciate how it might affect social change in the area of common concern – whether it is a shared social problem or a common geography. Second, by sponsoring and hosting forums, foundation leaders demonstrate the sort of public, symbolic commitment currently stymieing interest in L3Cs' businesses.

With these goals, a forum on impact investing would explore enticing opportunities and accompanying uncertainties. For example, despite the obvious temptation to dive into a

discussion of promoting and proliferating L3Cs, a more fruitful forum might revisit a more comprehensive and fundamental set of questions pertaining to impact investing, as presented in the callout box below.

The sample forum questions emphasize that developing new ways of creating and sustaining social impact inevitably requires

GUIDING QUESTIONS FOR IMPACT INVESTING ROUNDTABLE DISCUSSION FORUM

- What is your knowledge of mission-related investments such as low-profit limited liability companies (L3Cs)?
- How does your organization currently use program-related investments (PRIs) and mission-related investments (MRIs)?
- How would you rate your success of these investments?
- What factors – enabling or limiting – have you encountered with respect to PRIs and MRIs?
- What role *should* PRIs (such as investing in L3Cs) play in promoting social impact in the particular area or for the specific issue?
- How does the desired role for PRIs compare to existing practice?
- What are the primary factors enabling PRI investments in that area or for the issue?
- What are the primary factors inhibiting PRI investments in that area or for the issue?
- What resources – financial, human, and social – are needed to accelerate PRI investments in the area or for that issue?
- Where do these resources reside? Who controls these resources? How might these resources be organized to promote investment in PRIs in the area or for that issue?
- How might existing and new intermediaries accelerate PRI investments? What would a new intermediary look like? What would be its core activities, services, and tools?
- Over the next 12 to 18 months, what actions would most help promote and accelerate PRI investments in the area or for that issue?

considering a diverse set of new activities and relationships among institutional and individual actors. Industry reports on mission-related investing profile an exhaustive list of stakeholders, including social entrepreneurs, foundations, nonprofit leaders, venture capitalists, attorneys, and government policymakers. These reports detail how stakeholders are dedicated and often anxious to orchestrate social change. The vast majority of industry analysis describes the “who,” the “why,” and sometimes even the “what” of social impact investing. Yet few reports translate these activities into an actionable set of questions for stimulating greater awareness and understanding

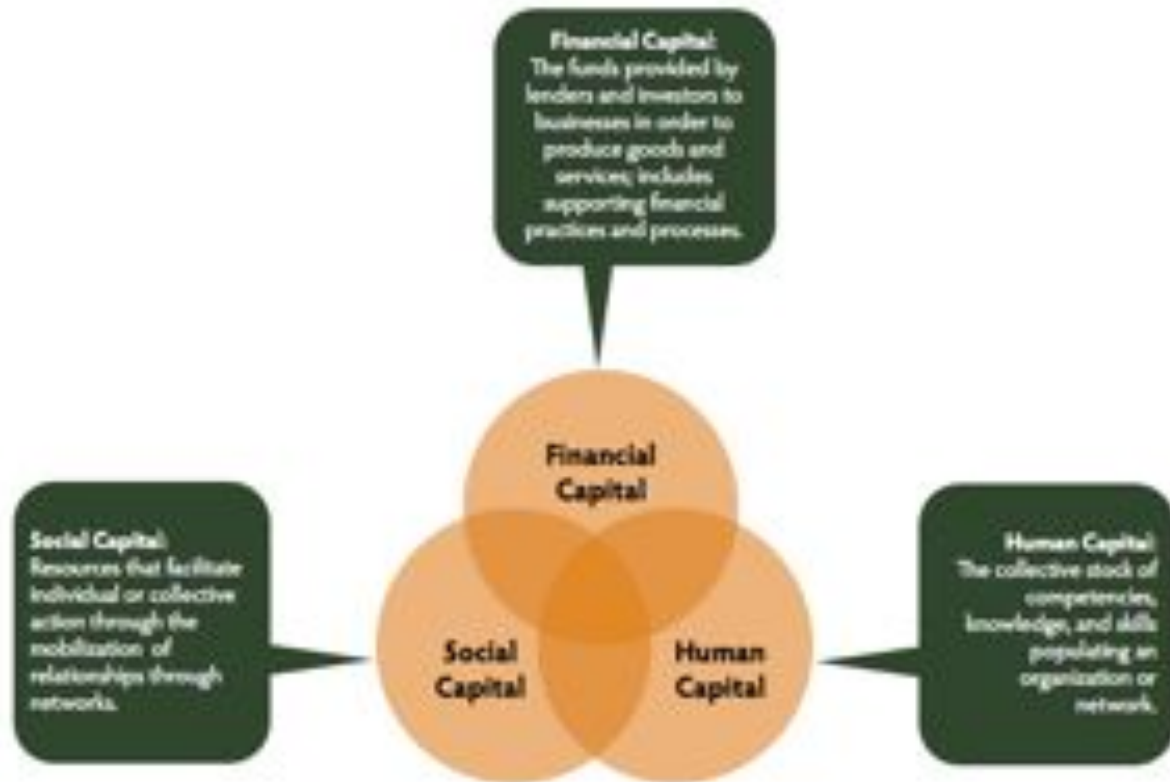
of impact investing. In contrast, the profiled questions strive to stimulate a richer dialogue exploring the opportunities and challenges of impact investing.

Nor do these reports categorize burgeoning mission-related activities into a broader framework of resources. In contrast, the profiled forum questions above reference three different types of capital – social, human, and financial – in order to underscore the diversity of activities needed to generate interest in impact investing. Philanthropic leaders often overstate the significance of financial capital while understating the potential power of social and human capital. "An overreliance on money as a change agent prevents the possibility for real change" (Monitor, 2010, p. 12). In addition to traditional grantmaking or mission-related equity investments, philanthropic leaders cannot discount their influence in convening dialogues that engage their diverse networks and compiling the technical expertise and knowledge among their staff, grantees, and board members (Monitor, 2010).

Put simply, foundations wanting to assume a leading and visionary role in promoting impact investing will need to leverage a more comprehensive set of assets and tools. One way to conceptualize this challenge is to conceptualize impact investing as a Venn diagram in which the nexus represents an integrated set of activities that leverage social, human, and financial capital, as presented below.

We provide greater detail explaining the potential role of social, human, and financial capital in helping foundations to generate interest in impact investing.

Figure 4: Financial, Human, and Social Capital in Impact Investing



Social Capital

The framing of impact investing as the collective will of individuals and institutions – not just donors and recipients engaging in traditional grantmaking – invokes substantive social capital. By social capital, we refer to resources that facilitate individual or collective action through the mobilization of relationships through networks.

An illustration of social capital activities can be gleaned from a comprehensive review of activities conducted by MRI-focused organizations. Two examples – Ashoka, a nonprofit organization connecting individual investments in social entrepreneurs, and the Aspen Network of Development Entrepreneurs (ANDE), a membership organization for small and growing business with a triple bottom line – capture the essence of social capital activities.

Table 1: Examples of Social Capital Supporting Impact Investing					
	Connecting via Social Media	**Establishing Forums**	**Creating Professional Networks**	**Expanding Professional Networks**	**Facilitating Knowledge Sharing**
Ashoka	Facebook, blogs sustain global community	Online space to develop sector-specific initiatives	Ashoka Fellows and Global Academy for practitioners	Create a culture of pro bono legal work	
ANDE		Advocacy campaigns and events	Convenes entrepreneurial members to share best practices		Online library of tools, templates, and directory

Table 1 summarizes some of each organization's activities from a social capital lens. The activities profiled in the table – connecting via social media, establishing forums, creating and expanding professional networks, and facilitating knowledge sharing – require stakeholders to prioritize collaboration as a norm. In order to promote social impact investing such as L3Cs, the field will need to establish diverse networks connecting ambitious social entrepreneurs, innovative philanthropists, and likeminded venture capitalists and private investors. In this respect, attending to social capital for impact investment merely represents a variation of how foundations already conceptualize traditional grantmaking.

Human Capital

The power of social networking is only as powerful as the human capital – or the collective stock of competencies, knowledge, and skills – populating a network. The development and diffusion of essential knowledge supporting impact investing remains a critical challenge in stimulating L3C businesses.

Once again, a review of activities within the broader landscape of impact investing offers insights. For example, Endeavor, an organization developing "high-impact entrepreneurs" in emerging countries, and the Omidyar Network, a self-described

philanthropic investment firm, reveal the beginning of a new knowledge set providing a more comprehensive approach to social change. Pierre Omidyar, the founder of eBay, and his wife founded the Omidyar Network to "invest in and help scale innovative organizations to catalyze economic, social, and political change." Omidyar emphasizes "the potential of individuals and the power of markets" (Omidyar Network, 2010). Not surprisingly, the Omidyar Network focuses on the potential of "high-growth entrepreneurs."

Table 2: Examples of Human Capital Supporting Impact Investing			
	Developing Business Knowledge	**Formalizing Entrepreneurship Curricula**	**Providing Consulting Services**
Endeavor	Mentoring, training, advising entrepreneurs	Partners with universities to create case studies	Offers strategic advice to entrepreneurs
Omidyar Network	Collaborate with investees in emerging markets by exchanging ideas		Offers in-depth expertise to investees' operations

A sample of salient human capital activities for the Omidyar Network and Endeavor appears in Table 2.

The stimulation of social impact investing requires developing particular skill sets. Although L3C businesses remain in their infancy, they have experienced enough growing pains to realize that the dearth of human capital with expertise in impact investing needs to increase before L3C businesses become a vital model for affecting social change.

Financial Capital

Social impact investing requires a distinct transactional space in order to flourish – separate from grantmaking and purely profit-driven or "financial first" alternatives. An examination of mission-related activities focused on financial capital helps to underscore the potential impact of impact investing.

A brief profile of three organizations highlights the types of financial capital activities associated with social impact investing. Registered as a 501(c)(3), GuideStar is "revolutionizing philanthropy with information." Their database profiling nonprofits expanded by 340,000 in 2005, adding to their total of over 1 million recorded charitable organizations (GuideStar, 2010). Subscriptions, licensing fees, and membership program fund GuideStar's operation. Two

Table 3: Examples of Financial Capital Supporting Impact Investing

	Standardizing Reporting	**Increasing Information Flow**	**Funding Marketplace Development**	**Providing Investment Portfolio Management**
GuideStar	Organizes nonprofit filings online	Offers financial analysis of nonprofits		
MissionMarkets		Provides transaction data	Hosts listing, trading, settlement and clearing activities	Enables online settlement tracking
Prosper		Lists borrower credit details	Supports peer-to-peer online investing	Provides electronic interface to analyze listing data and trading modules

other organizations, MissionMarkets and Prosper, are types of online marketplaces. MissionMarkets, a member-driven organization, focuses primarily on social and environmental capital markets, specifically regulated investment exchanges and credits. Prosper registers individual users to facilitate peer-to-peer investing based on an online auction platform. Table 3 diagrams each organization's activities in more detail.

This conceptualization of impact investing as a set of social, human, and financial capital activities begins to provide a framework for understanding the benefits and challenges of impact investing. First, this conceptualization underscores the interdependent nature of impact investing; for example, it will

be difficult to develop legal or financial expertise with L3Cs without expanding professional networks or attracting new talent to the field. Second, despite this interdependence, the sector has yet to observe organizations emerge as leaders, shaping and coalescing different audiences and interests. Yet the success of a few nascent social entrepreneurs might expand to different entrepreneurs and organizations addressing similar and different social problems if a set of organizations emerged as an organizing and catalyzing force. As outlined in this report, foundations are uniquely positioned to promote collaboration and partnerships by convening forums to discuss impact investing. In the next section, we examine these opportunities in greater detail.

#4 Developing Partnerships for Impact Investing

With the insights and strengthened spirit of collaboration from forums, foundations can begin organizing and mobilizing collaboration to catalyze impact investing. By assuming a leading role in sponsoring and convening forums, foundations situate themselves as the hubs of an expanding network committed to stimulating impact investing mechanisms such as L3C businesses. The Monitor Institute (2010) defines this kind of a unique role for foundations: "Funders are well positioned to support connectivity and to coordinate and knit together the pieces of a network of activity that can have impacts far beyond the success of any one grant, grantee, or donor" (p. 16).

In essence, foundations would be developing and mobilizing partnerships quite similar to the rich set of relationships foundations already nurture among a diverse set of stakeholders for traditional grantmaking. In addition to joining these stakeholders in discussions of social problems, foundations would lead the effort to stimulate these partnerships in support of impact investing such as L3C

businesses among representatives from business, government, peer foundations, and grant recipients.

An important stakeholder in this network remains existing grantees who may know little about mission-related alternatives, but may be interested co-constructing innovative solutions with foundations under new frameworks such as L3Cs. At the very least, existing grantees constitute an invaluable collection of expertise and experience from which to inform experimentation with impact investing. The Boston-based Barr Foundation, for example, funded the placement of "network weavers" throughout Boston who developed relationships and knowledge networks among service providers and community leaders in support of stimulating collaboration in after-school programming for youth (Monitor, 2010, p. 16-17). Yet wise foundation leaders will leverage their network of grantees while appreciating that not all nonprofit partners should be transformed into L3C businesses.

Through these networks and partnerships, foundations can assume instrumental roles in identifying and evaluating what social problems are best addressed through impact investing. Despite their traditional conservative bias, foundations *can* represent rich incubators for visionary "design thinking." Monitor (2010) describes design thinking as, "recognizing and engaging the people who will have to act, working together to test a range of possible solutions, creating feedback loops to facilitate learning, accepting and learning from failures, and practicing continuous adaptation" (p. 42). Our taxonomy of capital needs – social, human, and financial – provides a common language from which foundations and investors can organize such experimentation.

An essential question guiding such adaptation and experimentation is evaluating the extent to which existing

grantmaking practices provide sufficient solutions to addressing social needs of greatest interest to foundations, and whether impact investing such as L3Cs offers a complementary solution to help foundations broaden their "impact portfolios." Without a thoughtful framework for evaluating the "latest and greatest" in 21st century philanthropy, foundations may fall into a trap of merely "evolving" from latest trend to latest trend. As Monitor (2010) explains, "Strategies today must evolve on the basis of judgment that is actively and continuously cultivated, using multiple inputs and sources" (p. 20-21). Foundations are uniquely situated to stimulate social, human, and financial capital in order to seize this pressing opportunity.

CONCLUSION: EMBRACING ADAPTATION AND EXPERIMENTATION

When considering the significance and severity of the challenges facing many of our neighborhoods, communities and institutions there is understandable urgency to find better ways of addressing social problems and alleviating human suffering. But, impatience can overwhelm prudence when contemplating how best to stimulate social change on behalf of individuals, families, neighborhoods, and communities across the country and around the world. Whether from the perspective of philanthropists or social entrepreneurs, the multitude of problems seems to always outweigh the list of potential solutions. The impulse for action, therefore, becomes an inevitable reaction to the emergence of promising social innovations such as impact investing.

Our findings do not temper this impulse as much as we hope to direct it. In other words, we echo a voice that continues to influence the contours of social change in southeast Michigan and throughout the world, Mr. Max Fisher, "Most of us feel that the status quo cannot continue; we believe that the time has come to ask ourselves some basic questions." Instead of "what" and "why" ask "who," "how" and "when." By investigating basic questions, this report indicates that impact investing represents the latest chapter of experimentation in American philanthropy; and the newest variant of this trend, the L3C, offers clear benefits for social entrepreneurs wanting to stimulate social change.

Although this report summarizes the "what" and "why" of L3Cs, it more closely examines the "who" and "how" than other industry reports. The initial experiences of L3C entrepreneurs identify an essential role for foundations in promoting the

development of L3Cs. Without the program-related investments of foundations, L3C entrepreneurs fear that private investors will disregard their ventures; for private investors, the prospect of minimal returns only makes sense with the prospect of minimal financial risk. Yet once foundations offer both their financial support and stamp-of-approval to L3C businesses, L3C entrepreneurs believe that private investors will show greater interest in their nascent businesses.

The critical role of foundations, however, should not be limited to providing pre-seed capital to L3C businesses. Instead our findings indicate that foundations possess a unique opportunity to assume a leading role within the nonprofit, for-profit, and public sectors to generate greater awareness and understanding of impact investing, and specifically L3Cs. As observed with traditional grantmaking, the power of foundations extends well beyond their financial resources to include many social and human resources. In particular, foundations can assume a leading role in organizing forums and partnerships in support of developing and proliferating impact investing. By assuming such a leadership role, foundations do not need to reorganize their operations or undermine their traditional grantmaking. Instead this opportunity signals a genuine interest in advancing the type of adaptation and experimentation long associated with American philanthropy.

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