Michigan Impact Investing Network Hub Research Project

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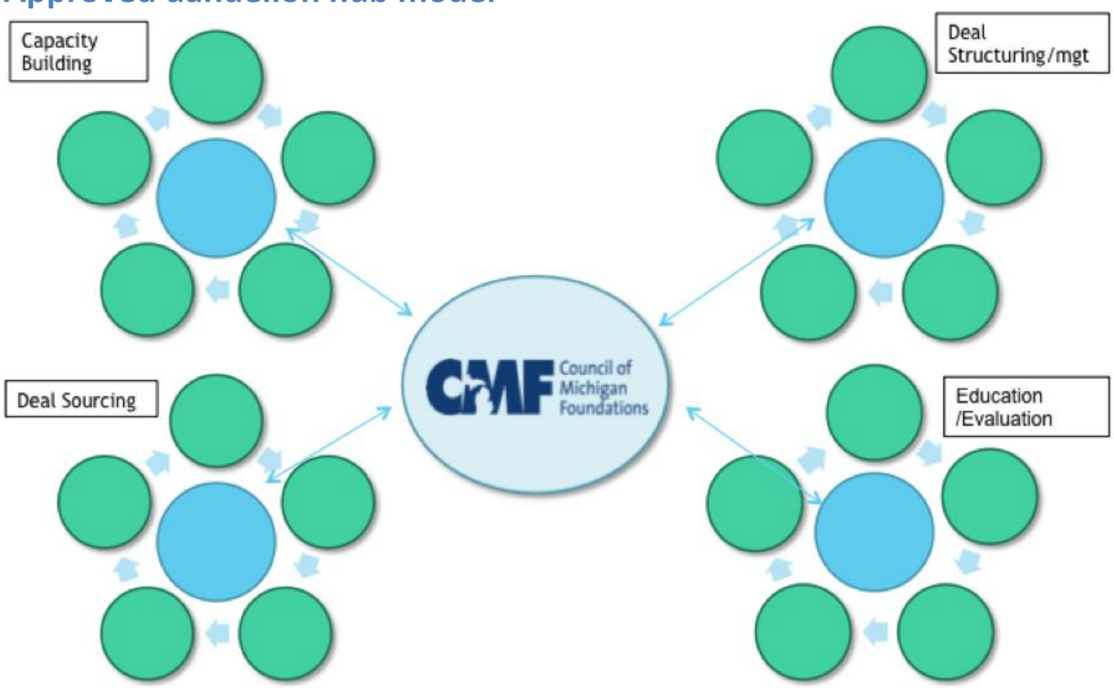
Background

CMF previously engaged Dione Alexander at RoundBox Consulting to carry out an assessment of the impact investing ecosystem in Michigan. The focus of this research was on:

- The interest and capacity of potential investors, investees, and service providers to engage in impact investing
- What tools and services CMF might deliver to best support this activity

Based on the results of that assessment the CMF Impact Investing Task Force approved the Dandelion services hub model shown below and authorized this research project.

Approved dandelion hub model



Methodology

Based on the approved dandelion hub model, this research was carried out with the goal of identifying the key actors and dynamics in 4 networks:

- Deal Sourcing
- Deal Structuring
- Capacity Building
- Education

Information was collected primarily through 33 telephone interviews that took place between March and May of 2015. Interviews were structured in two parts. The first section focused on the interviewee's experiences and views about Michigan's impact investing ecosystem. The second section directly asked interviewees to suggest key actors or refer additional contacts for interviews.

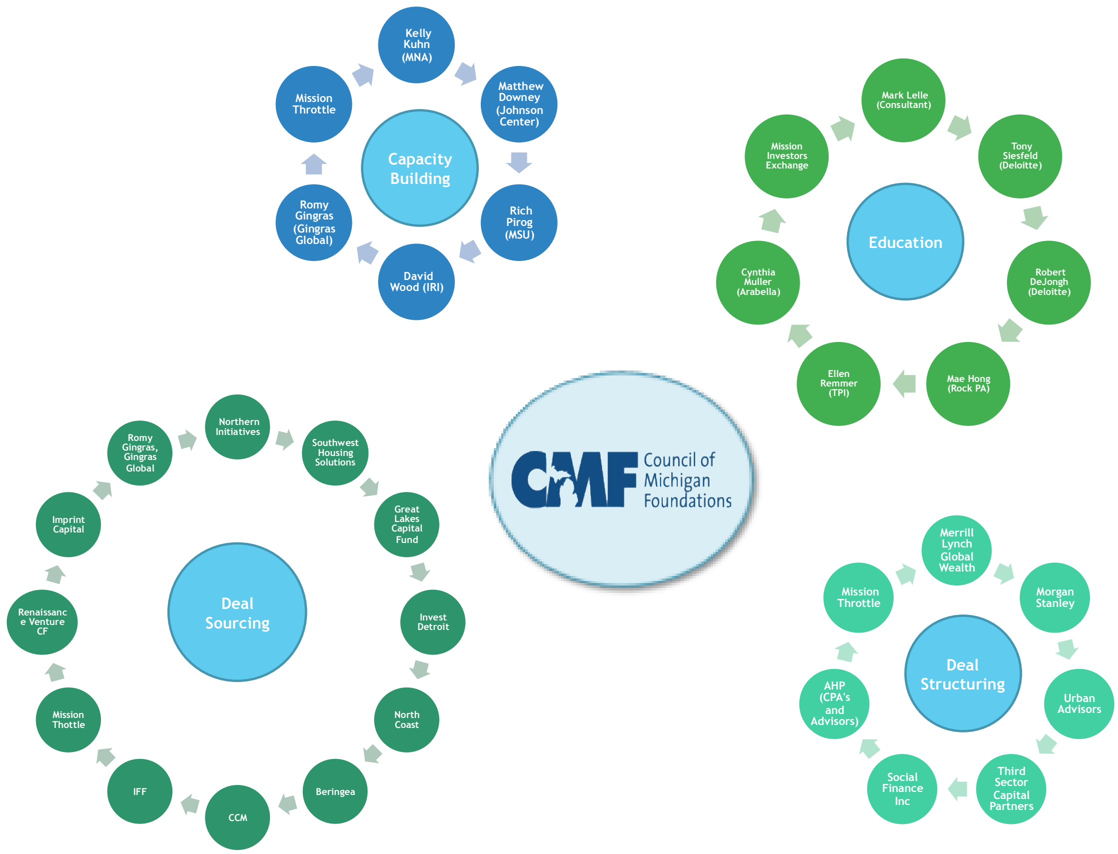
The initial interviewee list was compiled based on the approved dandelion hub with input from CMF staff and task force members. This list was iteratively updated based on the additional contacts interviewees suggested and independent online research.

Respondents were candid and generous with their time - the overall level of engagement was quite high. Following completion of the interviews, the initial population of the dandelion hub model and observations based on qualitative analysis of interview responses were presented to the CMF Impact Investing Task Force.

Dandelion network hub

The visual below shows the initial population of the dandelion hub model, including all of the interviewees except foundations, which are not shown because they would be represented in all four networks. This is not a closed system or an all-encompassing list: the goal is that these networks will expand over time as the hub begins to function.

Initial dandelion hub population



Proposed hub leaders

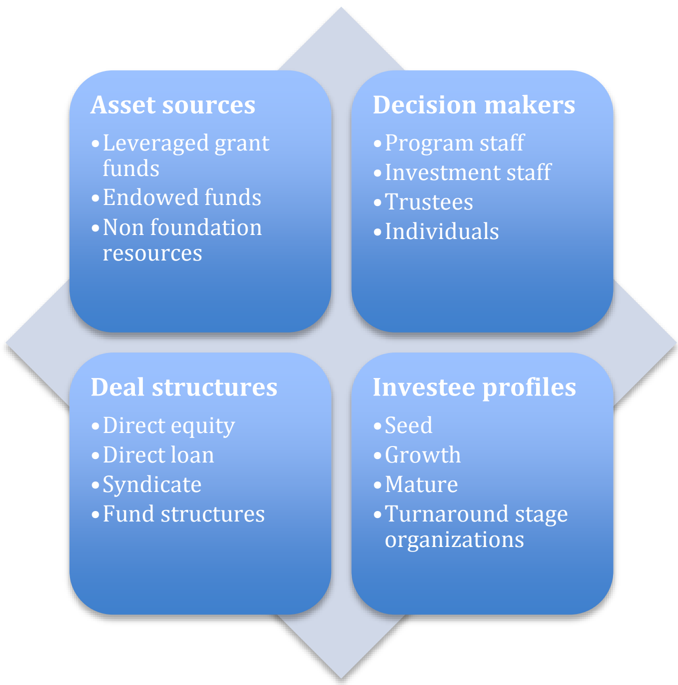
A successful services hub based on the dandelion model requires trusted partners to lead each of the nodes. A list of potential hub leaders based on these interviews is shown in the following table.

Hub	Proposed leader	Organization
Capacity building		
Education		
Deal sourcing		
Deal structuring		

Analysis

Observation 1: Using 1 term (impact investing) to address the entire ecosystem poses communication and execution challenges – there's not a shared common understanding

Impact investing encompasses a wide array of activities involving diverse asset sources, decision makers, deal structures, and investee profiles.



This complexity acts as a tax on communication, even for people and organizations deeply involved in the space. In fact, interviewees often asked me to provide a definition of impact investing or to confirm that we had a shared understanding of the term.

"Impact investments are investments made into companies, organizations, and funds with the intention to generate social and environmental impact alongside a financial return. Impact investments can be made in both emerging and developed markets, and target a range of returns from below market to market rate, depending upon the circumstances." – Global Impact Investing Network

This research was based on impact investing as defined by the GIIN, with a particular focus on investments made through PRI, MRI, and pay for success structures.

Observation 2: Building clarity around terminology & practices can boost deal sourcing efficiency

Within the foundation community, developing an understanding of which transaction elements are most likely to be stumbling blocks and how to uncover and communicate those issues early could streamline initial deal evaluation and cut down on false starts.

The distinction between Program Related Investments (PRIs) and Mission Related Investments (MRIs) is not generally understood both within and outside of the foundation community.

There aren't enough readily available service providers able to help foundations assess MRI products that may lead to market rate returns. This may be due in part to the historical perspective that social impact investments can't have market rate returns.

This lack of clarity was generally present among both potential investees as well as financially sophisticated actors with direct experience impact investing alongside foundations. This suggests that building a broader awareness of what impact investing means from a foundation's perspective among social enterprises and 501(c)(3)s could enable potential investees to actively seek out and prepare for investments, increasing the pipeline of potential deals.

Observation 3: Specializing can reduce execution and communication challenges

Foundations can reduce the burden of execution and communication challenges inherent to impact investing by specializing in deals that fit a specific profile. Many Community Development Financial Institutions (CDFIs) and Venture Capitalists (VCs) take this approach. For example, a CDFI might focus on structuring loans that unlock tax credits to fund affordable housing, or a VC may focus on early stage equity investments in companies developing mobile technologies.

This enhances efficiency in two key ways:

1. It supports development of a standardized approach to deal evaluation and analysis based on domain expertise.
2. It creates opportunities that potential partners and investees know how to leverage.

Observation 4: Developing impact investor / investee relationships could enhance outcomes

The relationships between foundations and investees have historically been very different from the relationships between foundations and grantees, in large part because they were focused on delivering different things: investees pursued financial returns and grantees pursued social impact. However, impact investing asks foundation investment and program staff, investees, and grantees to all consider both social impact and financial return. This alignment of interests creates opportunities to enhance outcomes by changing the nature of impact investor / investee relationships.

1. Leveraging untapped aspects of existing relationships
   For example, in the for profit space, companies often seek investors that bring not just capital but connections and expertise to the table. However, grant funded organizations often view capital sources as scarce, and as a result hide any potential issues from funders. This is suboptimal because it increases the risk that a potential issue eventually leads to failure, and over the long term also decreases opportunities for collaboration by slowing down the flow of information.

2. Rethink nature of relationships between foundations investing in social impact and the organizations delivering it
   It is possible that impact investing entails such a departure from established practices that it may fundamentally alter the nature of foundations' relationships with organizations across both the philanthropic and for-profit sectors. The private equity and venture capital industries have both seen substantial changes in the nature of the investor / investee relationship as they have grown. For example, foundations may find that providing investees with a program partner (similar to an operating partner in private equity) enhances social return. Additionally, with venture capital style incubators many current grantees may be able to develop business models that merit impact investments.

Observation 5: Adopting a capacity building mindset can strengthen deals

Many 501(c)(3)s don't have the organizational capacity to successfully accept impact investments. From their perspective accepting impact investments is much riskier than grant funding because it is outside their area of expertise. Unless investments include support for strategic business development, many 501(c)(3)s will lack the resources to develop and vet plans to return investment capital in addition to executing programmatic deliverables.

Foundation, board, and 501(c)(3) staff skill sets may not match the requirements of this work. Foundations lending to or investing in 501(c)(3) organizations can help mitigate these risks by adopting a capacity building mindset to guide the 501(c)(3)s through the continued business development and strategic planning needed to support successful repayment.

Next steps

This report and the interview response data attached in Appendix A are the final deliverables for this research project. The report has been updated to reflect the CMF Impact Investing Task Force's input so far. At this point, the task force is considering the following next steps:

- Import all data from interviews into CMF CRM systems
- Create a visual of what network might look like in real time
- Task force to decide what role will CMF play going forward

Acknowledgements

I would like to thank the CMF Impact Investing Task Force for inviting me to do this project, as well as all the interviewees who took time to have these discussions. It was a pleasure to work on this project.

Appendix A

Brenda Hunt, Battle Creek Community Foundation

Carmen Heredia Lopez, Dana Linnane, and Joel Wittenberg, W.K. Kellogg Foundation

Carolyn Cassin, Michigan Women's Foundation

Charlie Rothstein, Beringea

Chris Rizik, Renaissance Venture Capital Fund

Chris Uhl, Skillman Foundation

Cynthia Muller, Arabella

David Sand, Community Capital Management

David Sharp, Urban Advisors

David Wood, More for Mission

Dennis West, Northern Initiatives

Ellen Remmer, The Philanthropic Initiative

Jason Zylstra, DeVos

Joe Neri, IFF

Joel J. Moore, Merrill Lynch Global Wealth

John Goldstein, Imprint Capital

John Van Camp, Southwest Housing Solutions

Joyce Keller, Quicken Loans

Julie Ridenour, Steelcase Foundation

Kelly Kuhn, Michigan Nonprofit Association

Kim Dempsey, The Kresge Foundation

Mae Hong, Rockfeller Philanthropy Advisors

Mark A. Lelle Consultant in Evaluation and Planning

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Mark Rogers, Morgan Stanley

Matthew Downey, Dorothy A. Johnson Center for Philanthropy

Ray Waters, Invest Detroit (Detroit Development Fund)

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